Supreme Court, U. S.
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IN THE

Supreme Court of the United States

October Term, 1978

No. **78-294**

SOUTHERN CALIFORNIA EDISON COMPANY,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,

Appellees.

On Appeal From the Supreme Court of the State of California.

APPENDICES TO JURISDICTIONAL STATEMENT.

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APPENDIX A.

Decision of the California Supreme Court of March 23, 1978 (20 Cal.3d 813)

In the Supreme Court of the State of California.

Southern California Edison Company, Petitioner, vs. Public Utilities Commission et al., Respondents.

Opinion

MOSK, Acting C. J. — By this petition for writ of review Southern California Edison Company (Edison) challenges the lawfulness of portions of Decision No. 85731 of respondent Public Utilities Commission which require it to amortize, by 36 months of billing credit to its customers, substantial overcollections generated by operation of its "fuel cost adjustment clause." Edison's principal contention is that because the funds in issue were lawfully collected pursuant to a rate structure found by the commission to be just and reasonable at the time, the order to return them constitutes illegal "retroactive ratemaking." We conclude that the contention is without merit and the decision should be affirmed.

If the prohibition against retroactive ratemaking is to remain a useful principle of regulatory law and not become a device to fetter the commission in the exercise of its lawful discretion, the rule must be properly understood. In *Pacific Tel. & Tel. Co. v. Public Util. Com.* (1965) 62 Cal.2d 634 [44 Cal.Rptr. 1, 401 P.2d 353] (hereinafter *Pacific Tel. & Tel.*), the first decision of this court on the question,[1] we

[1]The Public Utilities Commission and its predecessor, the California Railroad Commission, had long before recognized and applied the rule against retroactive ratemaking. (See, e.g., *Re Pacific Tel. & Tel. Co.* (1949) 48 Cal.P.U.C. 823, 836-837, and cases cited.)

construed Public Utilities Code section 728 to vest the commission with power to fix rates prospectively only.[2] But we did not require that each and every act of the commission operate solely in futuro; our decision was limited to the act of promulgating "general rates." Thus we held (at p. 650 of 62 Cal.2d) that "the Legislature has not undertaken to bestow on the commission the power to roll back *general rates* already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a commission decision ordering a *general rate* reduction." (Italics added.) And we concluded by reaffirming (at p. 655) "the rule that *general rate making* is legislative in character and looks to the future." (Italics added.)

Pacific Tel. & Tel. was precisely such a general ratemaking case. There the commission conducted an extensive investigation of the rates charged by the utility in question, found them to be unreasonably high, and fixed new lower rates. In addition, however, the commission ordered the utility to refund to its customers all charges collected in excess of the new rate level since the beginning of the investigation. The order, of course, resulted in the new general rate structure taking effect retroactively, a disposition which we ruled beyond the statutory power of the commission.[3]

[2]Section 728 provides in pertinent part that "Whenever the commission, after a hearing, finds that the rates . . . collected by any public utility for or in connection with any service . . . are insufficient, unlawful, unjust, [or] unreasonable . . . the commission shall determine and fix, by order, the just, reasonable, or sufficient rates . . . to be thereafter observed and in force."

[3]*Pacific Tel. & Tel.* relied on a number of decisions of federal courts and our sister states which likewise held that rate-fixing orders could operate only prospectively. (62 Cal.2d at pp. 650-652.) But an examination of each shows that all involved various types of general rate orders and none remotely resembled the situation now before us.

The second decision of this court applying the rule against retroactive ratemaking was *City of Los Angeles v. Public Utilities Commission* (1972) 7 Cal.3d 331 [102 Cal.Rptr. 313, 497 P.2d 785] (hereinafter *City of Los Angeles I*). There the commission, after full hearings, found a utility's rates to be unreasonably low and fixed new higher rates. We issued a stay permitting the increased rates to be collected subject to refund pending our ruling on the petition for writ of review. In due course we annulled the decision, while recognizing that some rate increase was justified. The utility requested that we remand the case to the commission for the fixing of new rates and that the refunds be limited to the difference between such rates and those prescribed in the annulled decision. Again such an order would evidently have had the effect of permitting a new general rate structure to operate retroactively. We therefore reiterated the rule of *Pacific Tel. & Tel.* that "general rate making is legislative and looks to the future" (7 Cal.3d at p. 338), and directed refund of the entire rate increase. (*Id.* at pp. 356-357.)

We question neither the rule stated in the foregoing decisions nor its application to the facts there presented. But this is not such a case. At the risk of belaboring the obvious, we observe that before there can be retroactive ratemaking there must at least be *ratemaking*. There undoubtedly was ratemaking in both *Pacific Tel. & Tel.* and *City of Los Angeles I*; as we shall explain, however, ratemaking within the meaning of the cited decisions did not occur in the case at bar.

We begin with a review of the factual and legal background of this dispute. In a general rate proceeding in 1971 the commission granted Edison a rate increase of $105.5 million so that it might realize a return of 7.9 percent in the test year 1972. (*Re So. Cal. Edison Co.* (1971) 72

Cal.P.U.C. 282, 317.) The commission's estimate for Edison's cost of fuel in 1972 was based on actual prices paid in the period preceding the decision. In the months following the decision, however, Edison's fossil fuel costs — together with those of all utilities — rose substantially. Edison thereupon filed an application for immediate rate relief and for authority to amend its tariff to include an adjustment clause permitting periodic future billing adjustments "to reflect future increases in the cost of fuel." The commission granted an immediate rate increase of $14.3 million, and authorized the requested fuel clause. (*Re So. Cal. Edison Co.* (1972) 73 Cal.P.U.C. 180.)

The clause operated as follows: at regular intervals Edison prepared a forecast of the quantity of fossil fuel it would need to purchase in the ensuing 12-month period under average weather conditions. It then calculated the cost of such fuel at current prices, and compared that figure with the cost of the same quantity of fuel at the prices reflected in its existing base rates. If the difference worked out to .001 cent per kilowatt-hour or more,[4] Edison notified the commission of this fact by filing an "advice letter" requesting authority to increase future billings to compensate for its predicted higher fuel expenses.

Formal hearings on such requests were not contemplated; during the period here in issue none was held, and commission approval was routinely granted. In each instance the ensuing adjustment was then a matter of simple arithmetic: on each bill the number of kilowatt-hours sold was multiplied

[4]To give an idea of scale, we note that at the level of Edison's operations prevailing when the fuel clause was adopted a difference of .001 cent per kilowatt-hour represented approximately $460,000. (*Id.* at p. 186.)

by the "fuel cost adjustment billing factor" necessary to raise the additional revenue, and the resulting "adjustment amount" was added to the customer's monthly charge. The process was repeated in each billing until the next such adjustment was granted and took effect, and revisions of the billing factor were permitted as often as every three months. (*Id.* at pp. 184-185.)[5]

It is important to keep in mind that the periodic adjustments in Edison's rates brought about by operation of the fuel clause were intended to contain no element of profit whatever. A utility's rates are essentially the sum of two distinct components: its operating expenses and its return on invested capital. "The basic principle [of ratemaking] is to establish a rate which will permit the utility to recover its cost and expenses *plus* a reasonable return on the value of property devoted to public use." (Italics added.) (*City and County of San Francisco v. Public Utilities Com.* (1971) 6 Cal.3d 119, 129 [98 Cal.Rptr. 286, 490 P.2d 798].) It is thus elementary regulatory law that the "return" — i.e., the profit — of the utility is calculated solely on the rate base — i.e., the capital contributed by its investors; the utility is not entitled to earn an additional profit on its expenses, but only to "recover" them on a dollar-for-dollar basis as part of the rates. A fortiori, the same principles apply to an increase in rates resulting from operation of a fuel *cost adjustment* clause: as its name indicates, the purpose of such a clause is to permit

[5]For the theory and practice of fuel clauses generally, see Schiffel, *Electric Utility Regulation: An Overview of Fuel Adjustment Clauses* (1975) 95 Pub. Util. Fort. No. 13, page 23; *Sarikas, What is New in Adjustment Clauses, id.* at page 32; Trigg, *Escalator Clauses in Public Utility Rate Schedules* (1958) 106 U.Pa.L.Rev. 964; Comment, *The Fuel Adjustment Clause and Its Role in the Regulatory Process* (1976) 47 Miss. L.J. 302.

prompt rate adjustment to offset unusual changes in fuel costs, and no portion of such a rate increase may lawfully represent a profit to the utility.

It is clear that the fuel clause in the case before us was designed to operate within the law. The commission set forth its reasons for adopting the clause in a formal finding of fact: "Edison's proposed fuel cost adjustment billing factor will be adopted because (1) in an inflationary period with rapid changes in the cost of fuel, an expedited method is required to permit a utility *to recover these costs* so that its ability to function is not impaired; (2) because fuel costs are at least 20 percent of Edison's total costs, an expedited proceeding *to recover these increases* will lessen the frequency of general rate cases; and (3) the provision enhances a utility's position in the financial community." (Italics added.) (*Re So. Cal. Edison Co.* (1972) 73 Cal.P.U.C. 180, 190.)

As the emphasized language demonstrates, the purpose of Edison's fuel clause was primarily to permit the company to "recover" its increased fossil fuel costs in an expedited manner.[6] When in the following year the commission authorized the use of a similar fuel clause by the other major California electric utilities, it reiterated that purpose each time in identical words. (*Re Pacific Gas & Electric Co.* (1973) 74 Cal.P.U.C. 781, 790-791; *Re San Diego Gas & Electric Co.* (1973) 75 Cal.P.U.C. 267, 274.) And throughout the decision now under review the commission consistently describes the purpose of such fuel clauses as "dollar for dollar reimbursement" for the increased cost of fossil

[6]This reading is verified by a further finding in the decision, in which the commission declared the fuel clause would not be inflationary because "any price increases brought about by use of the fuel clause merely reflect the effect of past price inflation on the costs of fuel." (*Ibid.*)

fuel. (— Cal.P.U.C. —, — (Dec. No. 85731, p. 4; see also *id.* at pp. 7, 10, 21).)

Edison, however, appears to view its fuel clause as a device for accomplishing a wholly different purpose. This was made crystal clear in the lengthy testimony of Norman L. Codd, Edison's rate structure engineer and expert witness. Mr. Codd repeatedly denied that the fuel cost adjustment was an emergency measure with the limited goal of producing just enough additional revenue to offset specific, extraordinary increases in fossil fuel expenses; speaking for his company, he described the adjustment instead as a miniature rate proceeding intended to generate whatever higher rates were deemed necessary to prevent "decay" in the utility's overall rate of return on invested capital. These views were confirmed, for example, in the following exchange between the commission examiner and Mr. Codd:

"Q. [by Examiner Blecher]. That means, Mr. Codd, it doesn't make any difference what you collect, hoping you don't exceed the rate of return that is authorized, . . . is that correct? A. That is correct.

"Q. So that the fuel clause, there is no relationship to the fuel expense, . . . isn't that the effect of what you are saying? A. We are saying that the fuel clause itself, the revenues that come from it should not be compared directly with the expenses but rather [with] the total revenues derived by the base rates . . . to determine if the rate of return that the Commission found reasonable is being attained.

"Q. And you don't need a fuel clause, you just need a general rate case each time you need a rate increase because the effect of what you are saying would ignore the base purpose of the fuel clause, that is to provide emergency funds

to the utility for its immediate excessive fuel costs over that which was used in computing the rates in the last rate case, is that a fair statement, Mr. Codd? A. If the base rates could in fact be revised often enough . . . to result in a rate of return that the Commission has found reasonable, then I would say yes, we do not need a fuel clause. Unfortunately, our experience has shown otherwise.

"Q. Why do you neeed a fuel clause when you say that the amount of revenue that you collect under the fuel clause has absolutely no relation to the fuel expense as long as the amount of revenues do not cause you to exceed authorized rate of return? A. Without a fuel clause, the additional expenses that are incurred when we have increasing . . . fuel costs are such that *the rate of return would decay*; and we are trying to avoid that decay by . . . increasing prices." (Italics added.)[7]

This distortion of the purpose of the fuel clause permeates Edison's treatment of its overcollections of rates which began to accumulate shortly after the clause was put into effect.[8]

[7]Again and again the witness used similar language in describing Edison's understanding of the intent of the fuel clause. Thus he replied as follows to cross-examination by a deputy city attorney of the City of San Diego:

"Q. Now, the purpose as I understand it, of the fuel clause adjustment is to insure that the difference between revenues and expenses come[s] out even; isn't that true? A. I don't think I could characterize it that way.

"Q. Would you characterize it? A. I think as I've characterized earlier in my testimony and my cross-examination, the fuel clause was a device that was put into Edison's tariff schedules to help minimize or to *offset any decay in the rate of return* that would otherwise occur due to changes in the fuel and purchased power pricing mix that were being experienced by the company." (Italics added.)

[8]Edison's misconception also underlies its contention that it is entitled to keep these overcollections because during the years in question its actual rate of return averaged less than the minimum reasonable rate

(Footnote continued on next page)

Edison invoked the clause at every opportunity between May 1972 and December 1974, and in so doing raised its rates no less than 12 times. By the end of 1974, the cumulative total of costs charged to Edison's customers by operation of the fuel clause alone reached approximately $408 million.[9] During the same period, however, Edison's actual fossil fuel needs turned out to be far lower than predicted. The primary reason was unusually heavy precipitation during the 1972-1973 and 1973-1974 seasons. The phenomenon caused a substantial increase in the availability of hydroelectric power, which is a much cheaper source of energy than fossil fuels.[10] As a result, Edison spent considerably less for fossil fuels — and in particular for oil — than it had estimated in computing its adjustments under the fuel clause. Indeed, by the end of 1974 Edison had spent only $262.2 million of the $408 million billed for fuel expenses, leaving the company holding $145.8 million more than it needed to offset increased fuel costs. (Auditor General's Rep. p. 4.)

previously authorized by the commission. The contention fails for two reasons. First, as noted above, Edison was not entitled to earn a profit on its expenses. Second, even its lawful profit was not guaranteed. A utility is entitled only to the *opportunity* to earn a reasonable return on its investment; the law does not insure that it will in fact earn the particular rate of return authorized by the commission, or indeed that it will earn any net revenues. (*Power Comm'n v. Pipeline Co.* (1942) 315 U.S. 575, 590 [86 L.Ed. 1037, 1051-1052, 62 S.Ct. 736]; *Bluefield Co. v. Pub. Serv. Comm'n* (1923) 262 U.S. 679, 692-693 [67 L.Ed. 1176, 1182-1183, 43 S.Ct. 675]; *Re Gen. Tel. Co. of Cal.* (1969) 69 Cal.P.U.C. 601, 610; *Oakland v. Key System Transit Lines* (1953) 52 Cal.P.U.C. 779, 786.)

[9]Office of the Auditor General, Report on Adjustment of Electric Rates for Fuel Cost Changes (Aug. 1975) at page 4 (hereinafter called Auditor General's Rep.).

[10]A secondary reason was above-average temperatures during the same seasons, causing a substantial decrease in the demand for natural gas for heating purposes and a concomitant increase in its availability for generating electricity. Natural gas is a cheaper fuel than oil.

Not surprisingly, at the hearings below Edison's witness was extremely reluctant to admit that the company in fact treated such overcollections as earnings; rather, he took refuge in the repeated assertion that the funds could not be "isolated" from Edison's overall revenues.[11] It clearly appears from published figures, however, that Edison's overcollections pursuant to the fuel clause were not only large in the absolute sense, they amounted to a very significant proportion of the company's general revenue picture. For example, for the year 1974 Edison reported a total net income from all sources of $218.3 million;[12] yet during the same 12-month period, according to Edison's own figures filed with the commission in compliance with the decision under review, Edison's net fuel clause overcollections were $122.5 million — in other words, they constituted more than 56 percent of the company's systemwide net income for the entire year. Moreover, that net income was itself 47.8 percent higher than in the previous year, even though sales were lower; Edison's reported earnings per share were $4.10 for 1974, as compared with $2.70 for 1973; and the company's board of directors voted to increase the common stock dividend in 1974, the first such raise in three years. (Annual Rep., p. 4.) In announcing all these benefits to the shareholders, Edison acknowledged that the fuel clause adjustments, together with a general rate increase in late 1973, "contributed substantially to higher revenues." (*Ibid.*)

[11]This position drew the following reaction from the commission examiner: "if we isolate the fuel cost revenues in a separate [adjustment] proceeding, why would you not isolate the revenue that you received thereafter? You want to obtain the revenues in an isolated fashion to avoid the regulatory lag but you do not want to account for those revenues in an isolated fashion. I think that it totally inconsistent."

[12]Southern California Edison Company, Annual Report to Shareholders (1974) page 12 (hereinafter called Annual Rep.).

These continuing overcollections by Edison and other electric utility companies did not pass unnoticed. On the contrary, they triggered a sequence of public complaints, investigations, and proposals for reform or abolition of the entire fuel clause procedure. Among the most vocal critics were consumer groups (e.g., *The Fuel-Adjustment Caper* (Nov. 1974) 39 Consumer Rep. 836) and organs of the Congress (see Rep. of Subcom. on Oversight and Investigations of House Com. on Interstate and Foreign Commerce on Electric Utility Automatic Fuel Adjustment Clauses (Oct. 1975) *passim*).[13] The same overcollections were the primary incentive for the commission's order instituting the present investigation into the use and abuse of the fuel clause in California.[14]

While sharing many of the concerns voiced by critics of the clause, the commission determined that the cost adjustment concept should be preserved but the clause should be modified to eliminate the defects revealed by experience. The

[13]In the latter report, introduced as an exhibit in the proceedings before the commission, the congressional subcommittee declared it was "dismayed by the frequency in which fuel clauses have enabled utilities to bill consumers for fuel costs that were never incurred." (*Id.* at p. 6.) The report then singled out Edison as having "boasted of its profit-making fuel clause," and rejected Edison's rationale that "it is proper for a utility to overcollect through the operation of its fuel clause, provided the company's overall earnings do not exceed its authorized rate of return. Such a view would seem to contradict the industry's oft repeated assurances concerning the neutral effects of fuel clauses." (*Id.* at p. 7.) For these and other reasons the subcommittee found that "fuel adjustment clauses, in any form, are unwise, unnecessary, unworkable, and unfair" (*id.* at p. 1), and concluded that such clauses "should be abolished except during limited emergency periods. Even in such situations, all fuel adjustment clause charges should be subject to a prompt commission audit and refund with interest." (*Id.* at p. 3.)

[14]The investigation inquired into the fuel cost collection practices of Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (San Diego), and Sierra Pacific Power Company (Sierra Pacific), in addition to Edison. The resulting decision of the commission affects all four utilities, but only Edison has sought judicial review.

principal such defect, as we have seen, was the provision authorizing Edison to base its calculations on a prediction of its fossil fuel needs for the 12-month period following each application for a billing adjustment, premised on the assumption that "average" weather conditions would prevail throughout that time. The commission abandoned this procedure, and in lieu thereof adopted a clause which operates on a "recorded data" basis, i.e., on the *actual* fuel expenses incurred by the utility during the period *preceding* its application for a billing adjustment.[15] The utility is now required to maintain a monthly "balancing account," into which it will enter the amount by which its actual energy cost for the month was greater or less than the revenue generated by the clause; and on each occasion hereafter that the clause is invoked, the billing factor will be adjusted so as to bring the balance of this account back to zero. By this device the possibility of large over- or undercollections accumulating in the future is eliminated. And because the commission expanded the clause to include all sources of purchased energy — e.g., nuclear and geothermal, in addition to fossil fuels — it renamed the device the "energy cost adjustment clause."[16]

[15]A clause so designed, of course, eliminates all reliance on forecasts of weather conditions 12 months in advance, which the commission found to be both "inaccurate and unrealiable" in the present state of the art.

[16]There is nothing novel about a fuel or energy clause which operates on actual recorded data. PG&E proposed such a provision in the proceedings originally leading to its own fuel clause. (*Re Pacific Gas & Electric Co.* (1973) 74 Cal.P.U.C. 781, 786.) The fuel clause of Sierra Pacific has been based on recorded data since its inception four years ago. (*Re Sierra Pacific Power Co.* (May 8, 1973) Dec. No. 81355.) And on a nationwide scale, fuel clauses in all tariffs under the jurisdiction of the Federal Power Commission now operate on recorded data (18 C.F.R. § 35.14 (1975)), as do the majority of such clauses authorized by state regulatory agencies (see Trigg, *Escalator Clauses in Public Utility Rate Schedules* (1958) 106 U.Pa.L.Rev. 964, 976-979).

There remained, however, the massive overcollections accumulated by Edison, PG&E, and San Diego under the old fuel clause.[17] Treating these funds in essentially the same way as the monthly over- or undercollections to be adjusted under the new energy clause, the commission directed each utility to calculate a "fuel collection balance," i.e., the amount by which its actual fossil fuel cost incurred since its fuel clause took effect was greater or less than the revenue generated by the clause. But rather than subjecting the utilities to the financial hardship of reducing that balance to zero in a single stroke, the commission adopted a proposal urged by PG&E of allowing the companies to gradually amortize the sum by monthly billing credits spread over a period of three years.[18] That time span, the commission found, "is a fair and reasonable initial time period over which to amortize such difference, without unduly burdening either the utility or the ratepayer. . . ." (— Cal.P.U.C. —, — (Dec. No. 85731, p. 21).)

Seen thus in its full perspective, the transitional procedure adopted by the commission to deal with these overcollections is surely "fair and reasonable." It is not significantly different from the operation of the "billing account" under the new energy clause, and Edison expressly disavows any challenge to the latter device. For both analytical and legal reasons, it does not constitute retroactive ratemaking.

[17]According to Edison's figures filed with the commission in compliance with the decision under review, Edison's net fuel clause overcollections amounted to $133,241,000, as of April 30, 1976. The total fuel collection balance for all three major utilities exceeded $200 million. Sierra Pacific experienced a small undercollection in the operation of its fuel clause.

[18]PG&E's expert witness characterized this as "the conversion factor, which would be a downward adjustment in the fuel cost adjustment that would otherwise be in effect."

First, Edison has known from the very beginning that in our state favorable weather conditions inevitably alternate with unfavorable conditions, and hence that any overcollections the company might accumulate via the fuel clause would inexorably be followed by corresponding undercollections which would reduce its fuel collection balance to zero. Numerous witnesses before the commission recognized the existence of such weather cycles in California and their resulting balancing effect on costs and revenues under the fuel clause. Thus William M. Gallavan, PG&E vice president for rates and valuation, explained "there are cyclical changes in the weather conditions, and that is the basis for setting rates heretofore in California." With respect to variations in precipitation, for example, he noted that it requires an extended period of time "in order to complete the cyclical impact of the hydroelectric generation." John E. Johnson, supervising utilities engineer for the commission, went into further detail. He stated that because of these weather cycles, over- and undercollections pursuant to the fuel clause will balance out "given enough time." When asked if 30 or 40 years might be required for this purpose, he replied in the negative; based on his experience, it was unlikely in his opinion "that it would take as much as 10 years for the self-contained balancing process to work itself out with the present clause." The witness subsequently explained that over an appropriate time span the probabilities of favorable and unfavorable nonaverage weather conditions are "about equal," and that it is inherent in the concept of average-year ratemaking in California that "over a long haul the company or the utility *is made whole solely by reason of changing weather circumstances.*"

This view is supported not only by the record but by Edison itself. In its petition to this court Edison recognizes that the commission has traditionally made "the valid historical assumption" that "over a period of years variations from historical average weather conditions will balance out." And the same petition argues that if the weather cycle were allowed to run its course the present overcollections would likewise be balanced out: abnormally wet and warm conditions created this "temporary differential," Edison asserts, "and it is only the Commission's own decision to shift from an average-year forecast method to a recorded method that will prevent *the averaging out of the effect of weather conditions on the revenue-expense differential in the long run.*" (Italics added.)

It follows from Edison's own words that if the commission had allowed the current weather cycle to run its course, all overcollections would have been absorbed during nonaverage dry and cool years by Edison's greater fuel expenses, and the company's total dollar benefit from operation of its fuel clause would ultimately have been nil. The point was succinctly made by a dissenting commissioner in the proceedings below: although deeming the 36-month billing credit order to be retroactive ratemaking, that opinion concluded: "It does not follow from the above that we are powerless to prevent Edison from reaping a windfall. One way open is simply to maintain the average year forecast fca [fuel cost adjustment] until a complete weather cycle has occurred. In this way, the above-average wet years will be offset by below-average wet years in time." (— Cal.P.U.C. —, — (Dec. No. 86085, p. 4) (dis. opn. by Comr. Sturgeon).)

What the commission has done by adopting the present fuel collection balance procedure is simply to choose "another way" of preventing Edison from reaping the same windfall — a way which substitutes a definite credit period of three years in lieu of awaiting the natural completion of the current weather cycle, an event of uncertain date but statistically inevitable occurrence. Inasmuch as the two methods achieve the identical result — a final balancing of fuel clause over- and undercollections — and Edison itself embraces the former, the commission rightly concluded that it has not subjected Edison to retroactive ratemaking by choosing the latter because of a perceived need to institute the new energy clause without delay. Indeed, in view of the same weather cycle Edison cannot fairly complain that it has suffered the disruptive financial consequences of true retroactive ratemaking as exemplified by *Pacific Tel. & Tel. and City of Los Angeles I*: in the long run Edison admittedly had no expectation of retaining its present fuel clause surplus, and even in the short run it could not reasonably have relied on the use of that surplus because it must have known that in California drought can occur at any time.

Secondly, we do not write on a clean slate in this case. That the foregoing procedure does not constitute retroactive ratemaking within the meaning of *Pacific Tel. & Tel.* and *City of Los Angeles I* is demonstrated by our decision in *City of Los Angeles v. Public Utilities Com.* (1975) 15 Cal.3d 680 [125 Cal.Rptr. 779, 542 P.2d 1371] (hereinafter *City of Los Angeles II*). For present purposes we need not repeat in detail the complicated history of that litigation. (See *id.* at pp. 684-690; *City of Los Angeles I, supra*, 7 Cal.3d at pp.

336-340; *City and County of San Francisco v. Public Utilities Com.* (1971) *supra*, 6 Cal.3d 119 (hereinafter *City & County of San Francisco*).) It will be sufficient to recall the operative facts and our rulings insofar as here relevant.

Briefly, when a regulated utility switches from the "straight-line" to an "accelerated" method of depreciation for federal tax purposes, an immediate tax saving results. Under the procedure called "accelerated" depreciation with flow-through," that saving is passed on to the ratepayers: the utility pays its taxes on the basis of accelerated depreciation, and the rates are lowered because no more than the actual tax expense incurred is recovered from the ratepayers as a cost of service. Under the procedure called "accelerated depreciation with normalization," however, the tax saving is retained by the utility: the company still pays its taxes on the basis of accelerated depreciation, but the commission computes the taxes which would have been imposed if the straightline method had been used and permits the utility to recover that higher amount in the rates. The difference between the latter amount and the actual tax expense is set up on the utility's books as a reserve account for "deferred taxes." (*City of Los Angeles I, supra*, 7 Cal.3d at pp. 338-339 & fn. 3.) In practice, however, such taxes never materialize: because the utility's level of investment in a new plant typically equals or exceeds plant retirement, new depreciation deductions are continuously generated and the tax "deferral" in effect becomes permanent. In such circumstances not only are the ratepayers charged for tax expenses which the utility will never have to pay, but the balance in the reserve account is thus transformed into a capital asset of the utility upon which

it can earn interest or, if invested in plant, a return from the ratepayers. (*City of Los Angeles II*, *supra*, 15 Cal.3d at pp. 686-687, 690 & fn. 18.)

Prior to 1969 all utilities except Pacific Telephone and Telegraph Company and General Telephone Company of California used accelerated depreciation with flow-through; the latter two continued to use straight-line depreciation. In 1969 the federal tax law was amended to provide that utilities which had not theretofore adopted accelerated depreciation could do so thereafter only with normalization. The two telephone utilities subsequently switched to accelerated depreciation with normalization, and began accumulating the "reserves" described above. In *City & County of San Francisco* we annulled a commission decision which failed to consider possible ways of preventing the telephone utilities from keeping this windfall. "By permitting Pacific to include in its costs a charge for federal taxes greatly in excess of its actual federal tax expense," we reasoned, the commission in effect forced the ratepayers to contribute capital to the telephone system — a result wholly at odds with basic principles of ratemaking. (6 Cal.3d at p. 129.) Accordingly, we directed the commission to examine afresh all lawful alternatives for dealing with these "reserves." (*Id.* at pp. 130-131.)

Among the alternatives was a procedure which the commission thereafter ruled it had no legal authority to adopt: the annual adjustment clause. In *City of Los Angeles II* we addressed that question, and unanimously held the commission had the power to employ such a remedy. We began by explaining the operation of the adjustment clause: "the rate established by the commission includes a formula which, when applied each year to figures in the utilities' accounts,

produces appropriate adjustments in rates to keep them in step with the company's changing financial situation. In the case of annual adjustment to reflect the growing deferred tax reserves, the *actual* amount of the reserve accumulated by the utility would be compared with the amount used in the test year on the basis of which the commission set rates. As the reserve grew, the formula would effect a corresponding reduction in the rate base to take account of this new source of investment capital." (Fns. omitted.) (15 Cal.3d at p. 691.)

We then emphasized the difference between a true ratemaking proceeding, in which many variables are taken into account and broad policies are formulated, and the narrowly restricted and semi-automatic functioning of an adjustment clause: "The effect of annual adjustment in some respects resembles that which would occur if the commission each year conducted a new rate proceeding in which all factors except that of tax reserve held constant. In such a case the commission would look to the tax reserve as the sole relevant variable and reduce the rate base to compensate for tax reserve accumulations. As long as the commission's policy towards the tax reserve accumulations remained unchanged, however, *such yearly proceedings would reduce themselves to substantially ministerial steps*." (Italics added; fn. omitted.) (*Id.* at pp. 691-692.) In a footnote at this point (fn. 25) we identified the steps in question: "the regulatory commission's primary function should be to gather empirical data periodically on changes in each utility's tax reserve accumulations and then apply relevant data to the adjustment formula."

The relevance of *City of Los Angeles II* to the issue at hand is not a matter of speculation: throughout the opinion in that

case we relied expressly on the analogy between a tax expense adjustment clause and a fuel cost adjustment clause. For example, after the foregoing explanation of the essentially "ministerial" operation of tax adjustment clauses, we continued: "In similar circumstances the commission has concluded that the promulgation and periodic application of an adjustment formula more efficiently implements its policy. [¶] The commission thus employs adjustment clauses when it encounters an item of expense or revenue which tends to vary abnormally in comparison to the utility's other financial data; fuel cost adjustment clauses, which the commission presently inserts in the tariffs of power companies, constitute a prominent current use of such clauses. The commission's staff experts testified that the rapidly accumulating tax reserves presented an anomalous factor in the telephone companies' financial profile similar to that posed by the fuel costs of the power companies." (Fn. omitted; *id.* at p. 692.)

The commission nevertheless refused to consider adopting a tax adjustment clause because it believed that Public Utilities Code section 728 (fn. 2, *ante*) compels a full hearing before each application of an adjustment formula. Section 728, of course, is the statutory foundation for the hearing requirement in true ratemaking proceedings. We held that no such hearing is necessary each time the commission modifies the existing rate base by operation of an adjustment clause. After referring again to the commission's longstanding use of fuel clauses, we concluded: "the purpose behind the hearing requirement of section 728 demonstrates the permissibility of the annual adjustment scheme here at issue. The purpose of the hearing is to air the policy considerations behind various rate proposals and to establish controverted facts; as the

commission's experience with fuel clauses has shown, a hearing serves no purpose when the only business at hand is the application of a mathematical formula to a figure definitively established by reference to the utilities' books. The legislative purpose behind section 728 is better served by a plenary consideration of the advantages and disadvantages of an annual adjustment clause [i.e., at the time that clause is adopted in a true ratemaking proceeding] than by a yearly charade attendant to its application." (*Id.* at p. 697.)[19]

Thus although section 728 requires a hearing in every true ratemaking proceeding, *City of Los Angeles II* teaches that a hearing is not required each time the rate base is changed by application of an adjustment clause; it follows that in ordering such adjustments the commission is not engaged in ratemaking. The reasoning applies equally to the decision under review,[20] and it leads to the conclusion that in authorizing Edison every few months to adjust its rates by operation of the fuel clause the commission was not engaging in ratemaking. Because the increased charges thus imposed were not the products of ratemaking, they were not rendered inviolable by the rule against *retroactive* ratemaking. To put it another way, the commission's decision to further adjust

[19]For similar reasons we went on to hold that although a prior opportunity to be heard is also required by the due process clause in a true ratemaking proceeding, the Constitution does not compel such an unnecessary step before each subsequent application of an adjustment formula adopted in that proceeding. (*Id.* at pp. 697-703.)

[20]It is true that *City of Los Angeles II* authorized the use of a clause designed to adjust the *rate base* (*id.* at p. 691) to reflect the utilities' changing financial situation, while the fuel clause in the case at bar operated by means of a billing factor which had the effect of adjusting the *rates*. But the distinction is without practical effect: because one element of the rates is a return on the rate base, a sufficient change in the latter will produce a corresponding change in the former. The same result can thus be achieved by appropriate adjustments to either.

those rates so as to compensate for substantial past overcollections may well be retroactive in effect, but it is not retroactive *ratemaking*.[21]

An additional proof of this fact appears in the dispositive portions of our decision in *City of Los Angeles II*. We there proposed alternative methods by which the telephone utilities could be prevented from benefiting from the collection of rates which, although lawful, were higher than necessary because they had made provision for tax expenses that did not materialize. Among those alternatives, we advised the commission that it could compensate for such past overcollections by the device of reducing the utilities' rates of return in the future: "the commission could choose to mitigate the 'windfall' accruing to [the utilities] in consequence of their failure to elect accelerated depreciation prior to 1969, *by setting more modest rates of return* in recognition of the additional source of capital available to the utilities by virtue of the federal tax laws." (Italics added.) (15 Cal.3d at pp. 704-705, fn. 42.)[22]

Again the reasoning is applicable here,[23] and it fully supports the commission's decision to likewise "mitigate the

[21]Thus the commission was correct in formally finding that the rates fixed by operation of the fuel cost adjustment clause were not "general rates" but "extraordinary rates not created by or in a general rate proceeding"; and it was equally correct in concluding therefrom that "The future reduction of fuel clause adjustment rates is not retroactive ratemaking," even though designed "to reflect past over- or undercollections." (— Cal.P.U.C. —, —, —. (Dec. No. 85731, pp. 20, 23).)

[22]That this was not an ill-considered dictum is shown by the fact that we reiterated the proposal in our judgment. (*Id.* at p. 708.)

[23]Because of the interdependence of rate base, rate of return, and rates (see fn. 20, *ante*), there is no essential difference between offsetting past overcollections by adjusting future rates, as the commission did in the case at bar, and reaching the same result by adjusting future rates of return, as we said it could do in *City of Los Angeles II*.

windfall" in the case at bar by adjusting Edison's rates in the future so as to offset its past overcollections for fuel expenses which did not materialize. Surely our unanimous opinion in *City of Los Angeles II* would not have advised the adoption of an illegal procedure; and the conclusion is inescapable that if our proposal therein did not constitute retroactive ratemaking, neither does the commission's action here.

The decision is affirmed.

Wright, J.,* Elkington, J.,† and Sims, J.,‡ concurred.

CLARK, J. — I dissent.

Until today it was settled by statute and case law in California that "ratemaking" could not be retroactive. The Public Utilities Commission order patently constitutes retroactive ratemaking because it provides credits for the difference between lawfully fixed, final rates and those rates which in the commission's present view should have been collected.

The commission attempts to avoid the rule against retroactive ratemaking by claiming there is no retroactivity. However, the measure of the credit remains asserted *past* "overcollections," and, as the majority recognize, the credit is retroactive in effect. (*Ante*, p. 830.)

Rejecting the commission's attempted distinction, the majority attempt to avoid the rule against retroactive ratemaking on the theory that adjusting rates does not involve

*Retired Chief Justice of California sitting under assignment by the Acting Chairperson of the Judicial Council.

†Assigned by the Chairperson of the Judicial Council.

‡Retired Associate Justice of the Court of Appeal sitting under assignment by the Chairperson of the Judicial Council.

ratemaking. (*Id.*) Not only is the majority's basic premise fallacious, but their holding that adjustments are exempt from the rule against retroactive ratemaking effectively abrogates the rule, establishes a new system which can be manifestly unfair, and creates uncertainties which can only result in downgrading all California utility bonds, potentially costing our citizens billions of dollars.

Attempting to establish a need for retroactive ratemaking, the majority speculate that Edison received excessive profits during the periods involved here. The speculation is false and unwarranted. Edison's return for the period is before us as part of the record. But the majority chooses to ignore the record which shows Edison did not receive excess profits. To the contrary, Edison's rate of return fell below 8.2 percent approved by the commission. When those results are adjusted for the credits ordered, it is apparent that Edison's rate of return will be closer to 4 percent than to 8.

I. The Commission's Actions

On 18 March 1975 the Public Utilities Commission began to review the electric fuel cost adjustment of the major electric generating corporations. The commission concluded in Decision No. 85731 to abandon the existing method of computing the fuel cost adjustment and to substitute a new method, the energy adjustment clause. The commission also directed that future rates of the corporations be adjusted over a 36-month period, increasing or decreasing the rates by the difference between revenues collected pursuant to the old fuel cost adjustment and actual fuel costs.

In this review proceeding, Edison does not object to switching from the fuel cost adjustment to the energy adjustment clause; rather, it challenges the commission's order directing rate adjustment on the basis of past revenues and costs, approximating $177 million as of 31 August 1975.

The commission's general approach in rate proceedings is "to determine with respect to a 'test period' (1) the rate base of the utility, i.e., value of the property devoted to public use, (2) gross operating revenues, and (3) costs and expenses allowed for rate-making purposes, resulting in (4) net revenues produced, sometimes termed 'results of operations.' Then, by determining the fair and reasonable rate of return to be fixed or allowed the utility upon its rate base, and comparing the net revenue which would be achieved at that rate with the net revenue of the test period, the commission determines whether and how much the utility's rates and charges should be raised or lowered. . . . The test period is chosen with the objective that it present as nearly as possible the operating conditions of the utility which are known or expected to obtain during the future months or years for which the commission proposes to fix rates. The test-period results are 'adjusted' to allow for the effect of various known or reasonably anticipated changes in gross revenues, expenses or other conditions, which did not obtain throughout the test period but which are reasonably expected to prevail during the future period for which rates are to be fixed, so that the test-period results of operations as determined by the commission will be as nearly representative of future conditions as possible." (*Pacific Tel. & Tel. Co. v. Public Util. Com.* (1965) 62 Cal.2d 634, 644-645 [44 Cal.Rptr. 1, 401 P.2d

353]; *City of Los Angeles v. Public Utilities Com.* (1972) 7 Cal.3d 331, 336 [102 Cal.Rptr. 313, 497 P.2d 785].)

Among the costs to be recovered by electric utilities are their fuel costs for hydroelectric power, nuclear fuel, and for fossil fuels such as coal, gas, and oil. When Edison's rates were fixed in 1971, fuel requirements were estimated on the basis of historical average conditions of precipitation and temperature, a method used for many years. Fossil fuel prices were based on historical prices.

Recognizing that fossil fuel prices were increasing rapidly and that an expedited method of rate adjustment was required, the commission in 1972 approved a fuel cost adjustment allowing rate adjustments for fossil cost changes without a full rate hearing. The commission pointed out that the expedited proceeding would lessen the frequency of general rate cases and enhance the utility's position in the financial community. Application for adjustment could be made every three months.

To determine the appropriate adjustment under the fuel clause, Edison first estimated total energy requirements based on a 12-month forecast using average weather conditions. Edison then deducted the portion of the energy requirements to be met by nonfossil fuels. The remainder was the estimated fossil fuel requirement. By estimating current costs of gas, coal and oil and comparing costs of those fuels reflected in the base rates, Edison would fix the increase or decrease in revenue needed during the forecast period.

In years of above average precipitation, more hydroelectric power is generated than is contemplated by the original rates and by the adjustment since they are based on average year weather conditions. There is a large difference in cost

between hydroelectric power and fuel oil, and in wet years the fuel clause will produce revenue in excess of expense actually incurred. The reverse will be true in dry years. Over an extended period it is not unreasonable to expect excess revenue in wet years to roughly balance against the revenue shortage of dry years. However, because long range weather conditions remain unpredictable, there may be no balance, and over a shorter period, the likelihood is that revenues and expenses will not balance.

In its review the commission found that all filings by the utilities complied with the latter's fuel clause adjustments, the rates were just and reasonable, and all funds collected as a result of the adjusted tariffs were lawfully collected. Nevertheless, because of above average precipitation and because more natural gas was available than had been anticipated, the fuel adjustment resulted in an increase in actual revenues substantially exceeding any increase in fuel costs actually incurred.

Due to lack of correlation between actual revenues and actual costs under the old fuel adjustment, the commission decided to abandon it, switching to a new fuel adjustment based on actual or recorded costs. The commission also directed Edison to compute the amount of revenue collected and the increased fuel cost experienced under its fuel adjustment clause in the past and to credit against future charges for the next 36 months the amount by which the past revenues exceeded costs.[1]

[1]The amounts to be credited are characterized by the commission as "overcollections." Edison challenges the characterization on the ground the funds were collected pursuant to final rates lawfully fixed by the commission. The label placed on the amounts to be credited is not determinative. Rather, we must look to the basis of the credit.

Edison claims that the credit requirement is unlawful retroactive ratemaking and that, even if not, the credit requirement was improper because the basic rates plus the adjustment failed to produce the rates of return allowed by general rate proceedings.

II. The Rule Against Retroactive Ratemaking

Public Utilities Code section 728 provides: "Whenever the commission, after a hearing, finds that the rates . . . demanded, observed, charged, or collected by any public utility for or in connection with any service . . . are . . . unreasonable . . . the commission shall determine and fix, by order, the just, reasonable, or sufficient rates . . . to be thereafter observed and in force. . . ."

Section 734 provides: ". . . No order for the payment of reparation upon the ground of unreasonableness shall be made by the commission in any instance wherein the rate in question has, by formal finding, been declared by the commission to be reasonable. . . ."

In *Pacific Tel. & Tel. Co. v. Public Util. Com., supra,* 62 Cal.2d 634, 649-656, this court held the Legislature intended that rates be fixed prospectively only. In that case, the commission initiated an investigation of the utility rates, found the rates to be unreasonably high, established new lower rates, and ordered the utility to refund amounts collected in excess of the new rates during the period between the initiation of investigation and its order reducing rates.

Invalidating the refund order, this court reasoned that rate changes are legislative in character and prospective in application, that the language of section 728 is plain and unambiguous in requiring rates to be fixed prospectively, and that numerous courts in other jurisdictions have interpreted similar language as prohibiting retroactive rate reduction. It was also pointed out that Public Utilities Code section 734 prohibits reparations on the ground of unreasonableness of a rate where the commission formally found the rate to be reasonable and the charges had been collected accordingly. The court stated that policy arguments asserted in favor of granting the commission retroactive ratemaking authority should be addressed to the Legislature.

This court adhered to the rule against retroactive ratemaking in *City of Los Angeles v. Public Utilities Commission* (1972) 7 Cal.3d 331, 338, 355-359 [102 Cal.Rptr. 313, 497 P.2d 785]. There the commission granted a substantial rate increase to the utility, and on petition for writ of review, we granted a stay permitting collection of the increased rates subject to refund.

When this court annulled the rate increase and remanded the case for further proceedings, it was held that the entire increase must be refunded — the new rates being annulled, the old rates remaining in effect. We expressly rejected a claim by the utility that the refund should be limited to the difference between the rates collected and the rates to be set in further proceedings. It was not disputed that the preexisting rates — reestablished by annulment of the new rates — may have been unreasonable as of the date of the commission's invalid order setting new rates. Rather, assuming the evidence might warrant a finding of unreasonableness, the court stated: "To permit the commission to redetermine whether the preexisting rates were unreasonable as of the date of its order and to establish new rates for the purpose of

refunds would mean that the commission is establishing rates retroactively rather than prospectively." (7 Cal.3d at p. 357.)

It was noted substantial policy reasons exist both for and against permitting retroactive ratemaking and that it was for the Legislature to determine whether California should repeal its policy against retroactive ratemaking. (7 Cal.3d at p. 357.)

The rule against retroactive ratemaking places upon the utility the risk that in fixing the rate the commission erred in estimating expenses and revenues. If the estimated revenues were too high or the estimated costs too low, the utility will bear the loss and fail to recover the projected rate of return. On the other hand, if the estimated revenues are lower than those that actually occur or the estimated costs higher than actual costs, the utility will benefit. Because so many circumstances exist significantly affecting expense and revenue, it is to be anticipated that estimated costs and revenues will rarely, if ever, equal actual ones and that the utility will realize more or less than the predicted rate of return.

The rule against retroactive ratemaking serves to encourage efficiency because the utility will strive to hold down costs so as to increase profits under the established rate.[2] Permitting retroactive ratemaking would shift the risk of error in estimating costs and revenues from the utility to the consumer, reducing the utilities' incentive for efficiency.

The above cases establish that once a lawfully adopted rate is fixed a subsequent finding that it is either unreasonably

[2]The utility will be the immediate beneficiary of cost savings due to increased efficiency. However, when rates are adjusted, the adjustments will be based on historical costs, including savings due to increased efficiency. In this manner the ratepayer will ultimately benefit from increases in efficiency.

high or low does not justify either refunding excess revenues collected pursuant to the rate or retaining revenues collected pursuant to an invalid rate increase. To either refund or retain on the basis of what would have been a reasonable rate constitutes retroactive ratemaking.

The use of the credit system in the instant case likewise involves retroactive ratemaking. The credit is substantially equivalent to the refund. The basis of credit calculation is not estimated costs, revenues and rate of return for future activities but rather revenues collected in prior years and the revenues which in retrospect would have constituted a reasonable rate during past periods. There is no substantial difference — from the standpoint of ratepayer or utility — between repayment by way of credit against future billings of the assertedly excess amount collected and repayment by way of refund, the practice condemned in *Pacific Tel. & Tel. Co. v. Public Util. Com., supra*, 62 Cal.2d 634, 649-656. The commission is establishing a new rate for a past period and in effect requiring refunds for amounts collected in excess of the new rates, the practice condemned in *City of Los Angeles v. Public Utilities Commission, supra*, 7 Cal.3d 331, 357.

III. The Commission's Reasoning

Although the commission in the instant case found the old rates reasonable rather than unreasonable, this can furnish no lawful basis for the credit. It would be anomalous to permit the commission to require credits on the basis of reasonable rates while denying it power to grant credit for unreasonable ones.

The commission claims that the credit requirement is not retroactive ratemaking but merely an "adjustment of future"

rates based on an incomplete weather cycle. The commission points out that the original adjustment was based on average year weather conditions, and that over the years above average precipitation resulted in revenues exceeding costs. The commission asserts the credit system merely compensates for the balance of the weather cycle — because below average precipitation years may be expected in the future. However, future weather conditions are as unpredictable today as in 1972, 1973, 1974, and 1975. There is nothing in the record to show that three or four wet years will be followed by dry years, that there is a predictable weather cycle, or that Edison, should the average year calculation be continued, would have its so-called "overcollections" balanced by "undercollections" in the future. Moreover, even if a basis exists for concluding there is a predictable weather cycle, nothing indicates that it commenced in 1971 or did not end in 1975. So far as appears, the preceding four years when Edison was charging on the average precipitation basis may have been dry ones, yet no adjustment is made. Similarly, the next 10 years are as likely to be wetter than average as drier than average.[3]

The possibility that a new or different method of accounting practice for ratefixing might be more favorable to a utility, or fairer than an old method, does not warrant reducing rates for the future below those called for by the new

[3]While California experienced drought in 1976 and 1977, the drought mainly affected the northern and central parts of the state rather than the southern part — Edison's main area of operation. The water storage levels on the south coast were average and Colorado River storage above average as of 1 October 1976. While as of 1 May 1977 the south coast had dropped to 75 percent of average, Colorado River storage was at 130 percent of average on that date. (Water Conditions in California, Dept. Water Resources Bull. No. 120-77, Rep. No. 4 (1 May, 1977) p. 5; The California Drought — 1977: An Update, Dept. Water Resources (15 Feb., 1977) p. 5.)

method. As mentioned at the outset of this opinion, the basic system of ratemaking is to estimate the rate base, to fix a reasonable rate of return upon the estimated rate base, to estimate the costs of the utility, and to set the rates to provide revenues to cover the estimated return and costs. Adjustments to the estimated rate base or estimated costs used in fixing the rate will not be allowed unless justified by a showing that extraordinary rate base changes or cost or revenue changes may be reasonably anticipated to occur without compensating factors. (*City of Los Angeles v. Public Utilities Commission, supra,* 7 Cal.3d 331, 345-348, 351.) The credit provision does not reflect an estimated cost to be incurred, a factor to be included in estimated rate base, or an estimated revenue to be received, and thus the change in accounting practices does not justify the credit.

The reliance on weather cycles is a subterfuge — the basis of the credit provision is its measure, the difference between revenues received under the fuel adjustment and the actual costs of the fuel in past years. Requiring return of profits earned under prior lawful rates is the essence of retroactive ratemaking.

The commission attempts to rely upon language in *City and County of San Francisco v. Public Utilities Com.* (1971) 6 Cal.3d 119 [98 Cal.Rptr. 286, 490 P.2d 798] to the effect that it has the power to prevent utilities from resorting to accounting practices resulting in unreasonably inflated expense figures and may disallow expenditures reflecting unreasonable costs for materials. However, that case was concerned with the calculation of future costs for the purpose of fixing future rates — not for calculating past lawful profits for the purpose of refunds or credits against future rates. (6 Cal.3d at pp. 126-129.)

IV. The Majority Holding

The majority hold that adjustments of rates do not constitute ratemaking. This reflects a misunderstanding of the justification, procedure and result of an adjustment.

As pointed out above, rates are fixed on the basis of revenues, costs, the rate base, and the reasonable rate of return to be allowed the utility. Although a test year's figures are initially used, those figures may be adjusted to reflect reasonably anticipated changes to occur in the future. (*Pacific Tel. & Tel. Co. v. Public Util. Com., supra,* 62 Cal.2d 634, 644-645.) If the adjustments are to be made, they must be made throughout the equation — it is improper to adjust the expense side or rate base without also adjusting the revenue side, unless the expense or rate base adjustment is extraordinary in comparison to past practice. (*City of Los Angeles v. Public Utilities Commission, supra,* 7 Cal.3d 331, 345-348.)

In a growing state like ours it is obvious that revenues, expenses, and rate base will not remain constant but will increase. Whether test year results are adjusted for anticipated changes or not, the entire system of ratemaking is based on estimates of what the future will hold, and it is obvious that the estimates will rarely, if ever, be exactly realized. The basic assumption underlying the fixing of the rates on the basis of historical data is that for future years changes in revenues, expenses, and rate base will vary proportionally so that the utility will receive its authorized rate of return. (*City of Los Angeles v. Public Utilities Com.* (1975) 15 Cal.3d 680, 692 [125 Cal.Rptr. 779, 542 P.2d 1371].) The utility is required to record the results of its operations, and should it appear that the relationship is not being maintained, the

utility or the commission staff may institute proceedings for new rates.

Rather than require a full rate proceeding each time that it appears the anticipated results are not being obtained, in recent years the commission has provided for adjustments when there has been an extraordinary change of substantial magnitude in cost item or rate base. In the adjustment proceeding it is assumed that — except for the extraordinary item — revenues, expenses, and rate base have remained constant or have varied proportionately to each other. Thus the extraordinary change may be isolated, and a new rate fixed on the basis of calculations from the old one. As pointed out in *City of Los Angeles v. Public Utilities Com., supra,* 15 Cal.3d 680, 691, in discussing an annual adjustment for a tax reserve reducing rate base: "The effect of annual adjustment in some respects resembles that which would occur if the commission each year conducted a new rate proceeding in which all factors except that of tax reserve held constant."

The abbreviated adjusted rate proceedings will always reach the same result as if the commission had undertaken a general rate proceeding and used the same test year as it did in fixing the original rate, adjusting estimated revenues, expenses, and rate base for the extraordinary item. Rather than repeat all of the arithmetic, the commission merely adjusts for the extraordinary item.

It is clear from the foregoing that, contrary to the majority, the adjustment proceeding is ratemaking. It is the fixing of rates based on the assumption that — except for the estimate of the extraordinary item and the estimate of revenue needed to offset the extraordinary item — all revenue, expense, and rate base estimates shall be fixed on the basis of the original

test year. Moreover, once the adjusted rate becomes final it is the only rate which the ratepayers pay and the utility collects. There is no two-part system, an old rate and an adjustment; the old rates no longer exist.

The process used in fixing the adjusted rate is the same as the original rate proceeding, the commission not bothering to repeat its old estimates. The result of the adjustment is a new rate. Ratemaking procedures being followed and a new rate being established, we should recognize that the adjustment is ratemaking.

The majority's decision effectively abrogates the rule against retroactive ratemaking because the commission may avoid the rule whenever it chooses simply by denominating its rate-changing proceeding as an adjustment proceeding rather than a ratemaking proceeding. If we are to permit the commission to engage in retroactive ratemaking, we should require it to do the full job rather than permit it to choose its spots. The undisputed evidence in the record is that during the relevant period herein, Edison's total revenues — including those attributable to the fuel clause adjustment — were not sufficient to produce the rate of return authorized by the commission. Instead of credits against future rates, Edison would be entitled to surcharges. While true retroactive ratemaking is fair to the utility and the ratepayers, the commission's selective retroactive ratemaking approved by the majority may be and in this case is manifestly unfair.

It must also be pointed out that the majority is not loyal to its tenets. In approving the credits, because they are products of the adjustment proceedings, the majority fail to recognize that the basis of the adjustments — changes in the *price* of oil — did in fact occur. The credits — according to the commis-

sion and the majority — are proper because the estimates of *quantity* of oil to be used proved to be erroneous. But the *quantity* estimates were fixed in the original rate proceedings — so far as I can determine they were not adjusted in the adjustment proceedings. Thus, the credits are not designed to correct an error in the adjustment proceedings but an error in the original proceedings which was merely carried forward into the adjusted proceedings on the theory that all other matters remained constant.

We must also recognize the practical consequences of today's decision.[4] While it may seem inappropriate to invoke the characterization of penny wise and pound foolish in a case that directly involves over a hundred million dollars, the saying properly reflects the consequences of the majority holding. The uncertainties resulting from today's decision can only result in downgrading the securities of all California utilities. Today's decision means that investors contemplating purchase of bonds issued by California utilities may put only very limited reliance on the balance sheets and profit and loss statements. The investor looking at those documents must be aware that they are suspect because the commission — through an adjustment not subject to the rule against retroactive ratemaking — may refix the rates, thus requiring refunds or credits. Under the new California system the investor also will be denied the certainty of rate of return

[4]These consequences would not follow from the commission's decision, but they do follow from the majority's decision which is much broader. The commission's decision is predicated in part on the theory that the utility may avoid detriments — which would otherwise occur — by the change from the old fuel adjustment clause to the new one. This is a situation which would rarely occur. The majority's decision is much broader, holding rate adjustments are not subject to the rule against retroactivity. This decision may affect every utility rate in the state.

which would be guaranteed in a jursidiction establishing full retroactivity, i.e., the rates will be refixed allowing surcharges or credits to assure that the utility obtains its promised rate of return and no more.

The costs of downgrading cannot be minimized. As pointed out by the Wall Street Journal on 12 January 1978, page 19; with regard to a January 1978 bond issue of Pacific Telephone: "Pacific Telephone has the poorest credit rating among the 21 Bell System operating companies. Its obligations are classified double-A-minus by Standard & Poor's and double-A by Moody's, which lowered its rating from triple-A prior to yesterday's new sale. [¶] That downgrading by Moody's will raise Pacific Telephone's interest cost by 'approximately $35 million over the 40-year life of the $300 million issue,' an official estimated recently. Two earlier such rating reductions by Standard & Poor's effectively boosted the interest payments by about $55 million, he added. [¶] Moreover, Pacific Telephone's 61,000 bondholders 'suffer a loss in the market value of their securities of some $75 million,' Arthur C. Latno Jr., vice president for external affairs, said. 'When our debentures are downgraded for the third time in five years due to California's regulatory climate, it has to be a matter of grave concern to us and to every telephone user in the state,' he added."

Today's decision will no doubt require downgrading of Edison's debt securities because of the amount of money credited. More importantly, the uncertainties of selective retroactive ratemaking authorized by the majority will affect the credit-worthiness of all California utilities, and the potential cost will run into billions. As dissenting commissioners Symons, Jr. and Sturgeon pointed out: "It would be ironic

that the fuel cost adjustment clause, legitimately introduced to enhance the position of the utilities in the financial community and to guard that their ability to function be not impaired, be turned around like a boomerang to cause these very deteriorations it was supposed to prevent."

Even assuming that Edison did obtain excess profits or a so-called "windfall" during the period of the original fuel adjustment, the price that will be ultimately exacted from the ratepayers in order to permit the credits is too great. It may easily be in the billions. Moreover, the evidence in the record directed to the profit issue shows that Edison did not obtain the rate of return authorized by the commission during the period at issue. Although the adjustments viewed alone might be said to create a "windfall," other matters created a shortfall, and Edison's activities as a whole did not result in excess profits or a windfall.

The majority claim *City of Los Angeles v. Public Utilities Com., supra,* 15 Cal.3d 680, shows the credit does not involve retroactive ratemaking. However, the case did not involve a refund or credit of rates fixed, final, and lawfully collected, but merely a provision for adjusting rates to be collected after the adjustment became final.

I would adhere to the rule against retroactive ratemaking and annul Decision No. 85731 insofar as it provides for the credit.

Richardson, J., and Rouse, J.,* concurred.

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*Assigned by the Chairperson of the Judicial Council.

APPENDIX B.

Order Denying Rehearing
(May 25, 1978).

In the Supreme Court of the State of California in Bank.

Southern California Edison Company, Petitioner v. Public Utilities Commission et al., Respondents.

Order Due June 21, 1978.

Petitioner's petition for rehearing DENIED.

Tobriner, J., did not participate.

Clark, J., and, Richardson, J., are of the opinion that the petition should be granted.

/s/ Rose Elizabeth Bird

Chief Justice

APPENDIX C.

Decision No. 85731, Case No. 9886
(March 18, 1975).

Before the Public Utilities Commission of the State of California.

Investigation on the Commission's own motion into electric utility Fuel Cost Adjustment tariff provisions and procedures; and the changes, if any, that should be made to said tariff provisions and procedures.

(Appearances listed in Appendix 1)

Opinion.

On March 18, 1975 this Commission issued an Order Instituting Investigation (OII) in C.9886 for the purpose of investigating the electric fuel cost adjustment tariff provisions granted to the major electric generating corporations under our jurisdiction (all respondents herein), namely, Pacific Gas and Electric Company (PG&E); Sierra Pacific Power Company (Sierra); Southern California Edison Company (Edison); and San Diego Gas & Electric Company (SDG&E). The fuel cost adjustment (fca) provisions commenced with that granted Edison on March 21, 1972 and since that date to the present time these clauses have been operating as designed, with but minor modifications.[1]

The fca allows the electric utilities to arithmetically add an adjustment (billing factor) to their rates in order to provide for increases and decreases in the cost of fossil fuel. It was designed to operate quarterly by advice letter filings (although lately none have been granted without hearings by the Commission).

[1]For a complete listing of the case numbers and dates of authorization, see OII, C.9886 dated March 18, 1975, p. 1.

Generally, these clauses allow the computation of the billing factor on a future average-year forecast in the same manner as rates in a general rate proceeding are set and have been set for many years in California.[2] (All respondents except SDG&E have Federal Power Commission (FPC) fca provisions, though on a prior period basis.)

In our OII we concluded that the public interest required a thorough review of the operation of these fca tariffs to determine what, if any, changes should be made in them. On page 3 of the OII we set forth the purposes of this proceeding, as follows:

1. Whether there are reasonable alternatives to the use of average-year conditions as a basis for determining fuel cost adjustment revisions and, if so, whether any such reasonable alternatives should be adopted in this proceeding;

2. Whether the present fuel cost adjustment procedures should be revised;

3. Whether any revision should be made in the nature or amount of the evidence required to support the granting of fuel cost adjustment rate increases; and

4. Whether the Commission, in the lawful exercise of its jurisdiction, should in any other way modify the fuel cost adjustment tariff provisions of the respondents.

During the proceedings the issue of whether the prices paid for fuel oil should be publicly disclosed was added.

[2]Sierra has a recorded fuel clause although no reason for the distinction was made in granting this type of fuel clause to Sierra.

One of the major issues to be addressed in the OII (and which was one of its instigating factors) was whether or not the revenues collected by the respondent utilities under their respective fuel clauses were greater than the fuel expenses actually incurred and intended to be offset by these revenues. If there has been such an over- or undercollection, what adjustments are necessary, appropriate, and lawful to eliminate the cumulative excess or deficiency?

These issues, of course, have created a multitude of corollary sub-issues including, but not limited to, the validity of meteorological forecasting as it affects electric generation, the incentives provided by the current fuel clause and any alternatives, and factors affecting the precision and stability (or minimal variances) of the fca tariffs. Before proceeding with the discussion and analysis of the evidence, the various positions on the multiple issues, and our conclusions, we set forth the following assumptions:

1. That the fca was originally adopted because in an inflationary period, with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so its ability to function is not impaired; because such an expedited proceeding will lessen the frequency of general rate cases; and because it enhances a utility's position in the financial community (*Southern California Edison Company*, D. 79838 dated March 21, 1972).

2. That all moneys collected by the respondent utilities in the rates authorized as a result of the fca tariffs were lawfully collected after a finding by this Commission that the rates were just and reasonable.

3. That the clauses presently in effect pertain only to fossil fuels.[8]

4. That the existing clauses, except Sierra's, compute the fca on an average-year forecast method.

5. That in all previous filings made by the utilities under their respective fuel clauses they represented that no change would result in the then existing rate of return as a result of the revenues generated under the fca, since what was being generated was a dollar-for-dollar reimbursement for the increased cost of fossil fuel to be expected in the forecast period.

6. That all filings made under their respective fuel clauses by the respondent utilities have complied with the terms of their fca.

During the course of the proceedings PG&E moved to terminate the proceedings relating to the determination of an over- or undercollection of revenues compared to expenses under its fuel clause; and Toward Utility Rate Normalization (TURN) moved to immediately suspend the operation of the fuel clause and the rates and revenues generated thereby pending the decision in this matter. These motions have not been previously acted upon by the Commission. By reason of the decision herein, the issues raised are moot and, therefore, need not be decided and will not be further discussed.

Hearings were held before Examiner Phillip E. Blecher between May 5, 1975 and October 17, 1975, with the matter being submitted, subject to the filing of briefs, on the latter date.

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[8]Sierra had a purchased power clause added to its tariffs after authorization of its original fca.

The Evidence

The electric fuel clause originally arose because of the steep increases in fuel oil prices that commenced in the early 1970's. The decisions authorizing the fuel clause for various utilities beginning with D.79838 for Edison clearly indicated the purposes of the fuel clause as discussed on page [35]. The fca is basically determined by deducting from the total fuel requirements (based on forecast sales, in KWH) in the forecast period (under average conditions of temperature and precipitation) the fuel requirements in the forecast period expected to be supplied by nonfossil fuels; the balance is estimated to be supplied by fossil fuels (primarily gas and oil). The fca then provides for estimating costs at the latest known prices for the oil and gas, determining total estimated fuel expenses, and deducting the base cost fuel component included in base rates. The result is those revenues to be generated under the fuel clause as a result of the increase in fossil fuel costs over the fossil fuel costs used in determining the base rates.

Since the enactment of the subject fuel clauses there have been experienced above-average wet years. Theoretically, over an extended period of time these nonaverage wet years would be averaged out by nonaverage dry years. It is conceded that under the average-year forecast method, in a nonaverage wet year more hydroelectric power is generated and the requirements for fuel oil are diminished, and thus, because of the large difference in cost between fuel oil and hydroelectric power the fuel clause will generate much more revenue than the expense actually incurred or even anticipated to be incurred under average-year conditions. The reverse is true in nonaverage dry years. The meteorologi-

cal evidence adduced clearly indicates that forecasting weather conditions 12 months in advance is inaccurate and unreliable. It is only possible to predict the amount of hydro a few months before the hydroelectric power would actually be available, and then not always with any degree of accuracy. No other meteorological forecast in excess of 30 days has any more than marginal utility at best,[4] and therefore, the use of current-outlook forecasting of meteorological conditions is impractical under the existing state of the art. Although there is now experimentation in moderate and long-range forecasting taking place, a great deal of additional time and study is necessary before its feasibility can be verified.

The various utility witnesses, as well as the staff witness, concluded that the evaluation of the present fuel clauses should be on an average-year basis since this is how they were designed, although the utilities and the staff differed somewhat in their determination of what the average-year measurement should be. The staff witness also indicated that the measurement of the performance of the clause on a recorded basis, that is, comparing the revenues generated by the clause with the expenses actually incurred for additional fuel is inappropriate, though *actual* revenues received have been substantially in excess of *actual* expenses incurred when compared this way, but only as a result of various accidents of weather. It was pointed out that the opposite could result by opposite accidents of weather; this is obviously true. Thus, we have an important issue to be resolved here: What is the proper test of the performance of the existing fuel clauses?

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[4]PG&E's meteorologist indicates any weather forecasting past seven days is marginal.

The three respondent utilities having an average-year forecast fuel clause have on a recorded basis collected revenues which exceeded the expenses actually incurred for increased fuel expenses. As of August 31, 1975 these amounts were respectively as follows: PG&E—$156,265,000; Edison—$177.1 million; SDG&E—$1,789,100. For Sierra, which has a recorded fuel clause, there was an excess of actual expenses incurred over revenues collected of $324,246 as of June 30, 1975. The bulk of these amounts was accumulated during the record wet year 1974, as a result of the increased natural gas availability for electric generation during that year (compared to the forecasts) and the huge amount of hydroelectric power availability (and thus reduced need for much more expensive fuel oil). We do not agree with Edison's position that there is a distinction between determining the amount of overcollection as opposed to the test for proper measurement of the performance of the fuel clause. The annual reports published by the companies do not make such a distinction. The real world does not make such a distinction. The financial community makes no such distinction. We see no reason to make a distinction of that nature. The only measurement for the performance of the clause is how it performs in reality. The real world does not use average-year bases. The basic reason for this procedure was that it was thought it might allow a more accurate long-term correlation between revenues and expenses, though all the parties concede that there is really no such thing as an average year. Over some indeterminable period performance on an average-year basis might balance out, but we can see no reason why the utility should have the benefit of receiving large amounts

of additional funds for its use at the expense of the ratepayers simply because we are using a fictitious basis for determining its rates, particularly where the intention should be to match actual major increased expenses on a dollar-for-dollar basis. All performance is measured in reality. In our view it's the only proper test of the performance of the fuel clause which, in turn, determines whether or not there was an under- or overcollection.

Edison's 1974 annual report (exhibit 21) indicates that its earnings per share in 1974 were $4.10 compared to $2.70 in 1973, a 51.9 percent increase, while its pre-tax earnings from 1973 to 1974 went from approximately $193 million to $351 million, an increase of $158 million, an 81 percent increase. The other utilities also reflected as actual earnings the increase in revenues over expenses actually incurred as a result of the fca. Therefore, we think it reasonable that to determine whether or not the fuel clause performed as anticipated, it must be measured on an actual or recorded basis. This is notwithstanding Edison's protestations that the revenues generated by an increase in rates through the application on [*sic*] the fca should be distributed between fuel clause revenues and revenues generated by base rates (or the deficiency thereof due to base costs). This is specious reasoning since the fuel clause was designed to provide the difference between revenues generated by base rates (of which basc costs of fuel are one component) and eligible fuel expenses, though on an average-year basis. Thus, all the moneys generated over base rates are attributable directly to the fuel clause adjustment.

PG&E's position is that while it has had fuel expenses much less than revenue generated by the fca on an

actual basis, it has incurred, because of delays in the regulatory process, other expenses for which it has not been compensated by reasonable rates. We believe this to be an untenable position also as the fuel clause adjustment is an extraordinary proceeding designed for a specific, extraordinary purpose. It has no connection with applications for general rate increases and other matters but must be treated separately.

PG&E and Edison have adopted the position that regardless of how much money was collected under the fuel clause over actual expenses incurred, or any other basis, those revenues collected are inviolable so long as the utility did not exceed its authorized rate of return even though it may have increased its actual rate of return experienced on the date of the application for or granting of the fca. These arguments do not reach the issue. The issue is simply this; when we are changing to a new procedure based on actual energy costs from one based on average year experience in the middle of a weather cycle when the utilities have had the benefit of a series of wet years (with lower than average fuel costs), should we adopt a conversion adjustment of some type to prevent the utilities from experiencing windfalls by avoiding the adverse results of the dry side of the cycle. We conclude that such a conversion adjustment should be adopted. Accordingly, each of the utilities (including Sierra, which has a revenue deficit under its recorded fuel clause) will be directed to compute on an actual recorded basis (in a similar manner as the amounts set forth on page [39], supra, were computed), from its inception through the latest date available the amount of over- or undercollection experienced under its fca.

Having thus determined one of the basic issues in this matter, the question becomes: What, if anything, can and should be done about this?

All the moneys generated by the fca were lawfully collected. In our view, it is fair and reasonable that under- and overcollections be eliminated so that the fca effect shall be as originally intended—to reimburse the utilities for increased fossil fuel expenses. The only objection raised to any implementation of this view is the argument that it would constitute retroactive ratemaking, which is barred by Public Utilities Code Section 728 and various California Supreme Court cases interpreting it, primarily *PT&T v. PUC* (1965) 62 Cal 2d 634. The Court there said ". . . we have concluded that the Legislature has not undertaken to bestow on the Commission the power to rollback general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a Commission decision ordering a general rate reduction." (P. 651.) The Court also stated on page 652: "This Court has also declared the principle that 'The fixing of a rate in the first instance is prospective in its application and legislative in its character. Likewise the reducing of that rate would be prospective in its application and legislative in its character.' " (Citations omitted.) This language clearly bars the reducing or refunding of revenues under rates which were lawfully and finally effective.

We intend to do neither. However, we see no proscription in the cases discussing retroactive ratemaking (and contrariwise we see authority) for reducing rates prospectively even though that reduction may be appropri-

ate in part because of past performance. When we find overcollections we have the option of reducing rates or reducing the rate of return. (Cf. *City of Los Angeles v. Public Utilities* 15 Cal 3d 680, filed on December 12, 1975.) *City and County of San Francisco v. PUC* (1971) 6 Cal 3d 119 is analogous to the facts in this matter. In that case the Court said that this Commission has the power to prevent a utility from resorting to accounting practices that result in unreasonably inflated tax expense and may prevent a utility from passing unreasonable costs for materials and services on to the ratepayers by disallowing expenditures that we find unreasonable. It also said that by permitting a utility to include in its costs a charge for federal taxes greatly in excess of its actual federal tax expense, this Commission deviated from the basic principle of utility rate setting calling for the establishment of a rate that would permit the utility to recover its costs and expenses plus a reasonable return on the value of property devoted to public use. If we substitute the words "fuel costs" for the words "federal taxes" and "federal tax expense", this language would be completely apropos to this proceeding and we so find it to be. We see no distinction between unreasonably inflated federal tax expense and unreasonably inflated fuel cost expense though the latter may have been completely unintentional and caused by unanticipated weather accidents.

Several parties in this matter advanced the theory that the fca, because it is generated by an extraordinary proceeding which might be characterized as a special proceeding and not as part of a general rate proceeding, should be treated in a manner different from general rates. This concept could be implied from the language

used by the Supreme Court, *supra*[5] in its discussion about general rates. We think this is a valid distinction. All the parties agree that the purpose and intent of the fuel clause is to match increased fuel costs with increased revenues on a dollar-for-dollar basis. There is no intent to provide either the utilities or the ratepayers with a windfall. Had the amount of overcollection occurring to date been an equal amount of undercollection, we believe the utilities would have been before this Commission forthwith with applications for rate relief to assist them in keeping their operations viable. Now it is of academic interest since the shoe is on the other foot; we think the shoes on both feet should match. We believe the public interest requires this Commission to balance these interests. Therefore, we hold that the distinction between general rate revenues and fca revenues is so clear that there is a correspondingly clear distinction between fca increases and general rate increases.

Thus, we shall compute the specific amount of over- and undercollection for each of the respondents under their respective existing fuel clauses as of the latest date available and amortize that amount, adjusted as appropriate, initially over a period not to exceed 36 months[6] and order a commensurate reduction in rates, subject to revision. Interest will be included on this balance at the rate of 7 percent per annum (the legal rate of interest in California) starting with the Fuel Collection Balance as determined as of April 1, 1976.

[5]*PA&T v PUC* (1965) 62 Cal 2d 634.

[6]Recommended periods of possible amortization of such revenues ranged between 2 and 60 months.

The next matter to be determined in this proceeding is whether the existing fuel clause should be revised, and if so, how? TURN suggested the abolition of the fuel clause.

The reasons given for authorizing the existing fuel clauses—inflation, rapid changes in the cost of fuel, need to prevent impairment of the utility, lessen frequency of general rate cases, enhance the utility's financial position—are still valid, perhaps even more so because of the large increase in the ratio of fuel costs to total costs.[7] But it must be borne in mind that the original purpose was to provide for *rapid* increases in the cost of fuel, not merely any increases, as increases have occurred in all the other expenses borne by a utility.

We believe that it is appropriate to adopt a regulatory procedure for reflecting in rates substantial changes in fuel costs. We do not believe, however, that any such procedure should be "automatic", nor that it should dispense with the safeguards of public hearing and independent staff review.

Edison desires and has recommended the continuation of its existing average-year forecast fuel clause with certain modifications, which in its opinion more clearly reflects today's realities. SDG&E has recommended a current-outlook fuel clause, which is basically a forecast fuel clause estimated on approximately a three-month basis (in lieu of the 12-month basis, as at present). PG&E and Sierra have recommended generally the use of a recorded fuel clause with a balancing account.

[7]At the time of the authorization of the existing clauses fuel costs ranged from 17 to 20 percent of total costs. The record here indicates that fuel costs are now approximately 50 percent of total costs.

One of the areas of controversy revolves around the procedure of forecasting estimates of future data (sales, revenues, etc.). This can be avoided simply by using recorded data, since all parties concede that controversy over the method of determining the fuel clause revenues should be avoided, as should potential overcollections by the utilities. But determining that we are going to use recorded data still leaves many matters to be resolved for the specific formulation of the fuel clause.

A. *What type of recorded basis?*

We think the best fuel clause is that which uses recorded data over a full cycle of experience, seasons, temperature, and weather conditions. This means a 12-month moving recorded basis for sales and quantities of energy, since it will absorb all the peaks and valleys of a full cycle of variables. To most accurately reflect energy costs, we shall compute the costs of energy on an end-of-period basis. During the last month prior to the time for energy clause application, the cost of fuel oil shall be computed on a weighted average cost basis of the inventory then existing; all other energy sources shall use the latest tariff, contract, or delivered price figure for the cost, for purposes of the energy clause.

B. *Filing Interval*

We believe that a six-month filing period will tend to stabilize rates, reduce the frequency of rate changes, and simplify the administration of the fca to obtain the best possible review of the data. After evaluating the performance of the new clause we are authorizing here, we may amend this interval to more adequately accomplish the objectives of the new clause. The utilities

will be required to submit their initial filing as soon as possible, after which we will establish a staggered filing schedule, assigning specific dates to each utility.

C. *How are we going to match revenues and expenses more closely?*

This can be accomplished by the introduction of what has been called a balancing account (or deferred energy accounting system), on the books of the utility. Each month the utility will record the required data pertaining to energy revenue and expense to determine what its increased cost was for the month on a recorded 12-month rolling average basis. If the amount of cost exceeds the amount of revenue generated in that month by the clause (or, prior to the first adjustment factor, adopted base rates), a debit should be entered in the balancing account, indicating the utility has funds coming to it at the time of the implementation of the next adjustment factor. If the revenue has exceeded the cost of energy, on the same basis, for that month, then an entry on the credit side of the account should be entered to indicate the utility has collected excess revenue over energy cost, which will be accounted for at the time of the implementation of the next change. At the last day of the third month preceding the date for implementation the account should be balanced out to implement the next filing.

D. *What shall we do with the previous over- or undercollections arising from the existing fuel clause?*

A Fuel Collection Balance for each utility shall be computed by the Commission at the time the new clause goes into effect. It would commence with a debit balance if the utility undercollected or a credit balance if the revenue exceeded actual fuel cost during

the period in which the previous fuel clause was in effect. At the time the beginning balance is finally determined, as discussed earlier, a monthly collection factor would be determined on a recorded latest 12-month sales basis and added to or subtracted from the FCA or ECAC rates then in effect. The over-collection credit would be developed on a uniform cents-per-kwhr basis applicable to all appropriate sales and the credit would be specified separately. Any collection debits would be developed as part of the energy cost adjustment factor and applied on a cents-per-kwhr basis only to sales above lifeline quantities. All energy cost adjustment factors and collection balances would be reviewed on a periodic recorded basis to determine their operation.

The collection balance, in order to be added to or subtracted from the rates, would be amortized initially over a period of 36 months so that 1/36th of that amount would be effective for each month and, therefore, for an adjustment to be carried over a period of six months, one-sixth of the total collection balance would be added to or subtracted from the then existing rates, as indicated above.

Consistent with the treatment of the ongoing revenue-expense imbalance indicated in Section C, above, as historical behavior of the Fuel Collection Balance amortization develops we reserve final resolution of the amortization mechanism to a future time. Our intent, however, is to maintain future clause recorded revenue-expense differentials at a minimum and to bring to zero the existing Fuel Collection Balance, within a reasonable time, but not to exceed 36 months. Interest will be included at the rate of 7 percent per annum starting with the Fuel Collection Balance as determined as of April 1, 1976.

E. *How are we to determine whether the fuel costs paid by the utilities are reasonable and proper?*

We contemplate that only reasonably incurred reasonable costs for fuel are to be recovered. To determine this in the annual review, we would require the utilities to file with us all fuel oil contracts, written solicitations, bids, and offers whether for long-term or spot purchase, for the sale of fuel, with adequate documentation as to dates, terms and other pertinent data, and explanation of the reasons for rejecting each such bid, offer, or solicitation.

F. *Should public disclosure of fuel oil prices be required by the Commission?*

The utilities maintain the position that such public disclosure will be detrimental to them in negotiating both long-term and spot purchases of fuel oil, since their suppliers may know prices and terms they are paying to competitors, thus disadvantaging the utility in negotiating better terms than presently exist in their oil contracts. In the event that the question of reasonableness is legitimately and properly raised by any of the parties to a proceeding, including the staff, then the documentation submitted as far as necessary to determine the question of reasonableness would be subject to public disclosure at hearings or otherwise. This may be determined by the presiding examiner.

G. *What fuels are to be included in the fuel clause?*

To be fair and consistent, we are including *all* energy sources in the new clause except utility-owned hydro-electric power. This will enable the utility and its ratepayers to reflect the true cost of energy sources on a system-wide basis. The total cost of all sources is to be computed on the past 12-month quantities

of energy by applying the end-of-period prices of each in determining the adjustment factor.

H. *How will this clause affect incentives to minimize fuel costs?*

The effect on management of any form of fuel clause, apart from the inherent incentive of management to operate as efficiently as possible to improve earnings and avoid regulatory review, is to reduce the incentive for minimization of fuel prices, since the utility obtains in rates that which it spends for fuel. An incentive in the proposed clause lies in the fact that the use of recorded data on a 12-month basis will always result in a gap between last experienced prices and the amounts recovered on a system-average basis, either up or down.

I. *Base Cost*

One of the problems in the implementation of the new clause is where to peg the base cost of fuels. Several possibilities have been suggested: the existing base cost component of base rates; rolling in previous fuel cost adjustment components into existing base rates and using the resultant figures; reducing base cost to zero (so all fuel costs would be computed under the fuel clause), depending on the type of fuel clause adopted; recomputing base costs on either an average-year forecast, current outlook, or recorded basis. For the time being we will utilize the existing base fuel cost component of base rates adjusted to reflect all energy sources. This will allow the new clause to initially reflect the difference in total energy cost and base cost. We intend to modify the base cost to zero in the pending SDG&E general rate proceeding. The base cost for PG&E, Edison, and Sierra will be modified in *new* general rate proceedings filed subsequent to our determination on SDG&E.

J. *State Water Project and Other Special Contracts*

PG&E, Edison, and SDG&E have contracts with the State Department of Water Resources (DWR) and others dating from the mid-1960's, some of which cannot be renegotiated until the mid-1980's. The prices for sale and purchase are thus fixed. In computing previous fca's, these sales were included in the utilities' sales forecasts, having the effect of computing the fca rate as though it applied to these sales, while the savings due to the purchases from DWR and others are not accounted for. The three affected utilities maintain this is unfair, and is becoming an increasingly more serious problem as the cost of generating power keeps increasing. We agree with the utilities and will allow them to deduct these sales from total KWH sales in computing the new adjustment factor, to the extent that such sales do not exceed purchases from the state water projects and others. To the extent that prices for purchases from DWR and others are less than prices for sales to DWR and others, there will still remain a net saving to the ratepayers if such sales and purchases are equal, while allowing the energy cost adjustment revenues to match actual energy expenses more accurately.

K. *Btu v KWH*

Our present fuel clauses reflect the heat rate, which is the amount of heat (Btu's) necessary to generate a KWH. The purpose is to provide the utility with an incentive to improve its heat rate (and thus its efficiency) to create additional revenue to be generated by the fuel clause. Because base rates are formulated

on a KWH basis, we believe it is appropriate to have the clause reflect the KWH basis also, as it will then more correctly reflect the cost of fuel and energy necessary to generate or purchase the power available for sale. The fuel cost recovered through sales of fuel to others is to be deducted from any fuel cost to be recovered under the clause, as is presently done.

L. *What costs are to be recovered in the procedure?*

The delineation of specific items of cost to be included involves some hairline decisions. Generally, we think it reasonable to include the direct reasonable cost of fuel and energy and other variable charges directly associated therewith. This is generally in line with the recommendations of both the Utilities and Finance and Accounts Divisions of our staff. Thus, we shall exclude fixed charges, costs not directly attributable to energy sources, and costs primarily accounted for in general rate proceedings. This excludes all costs relating to company, affiliate or subsidiary owned transportation (including pipeline) and storage facilities, unloading charges from transportation facilities, tankers under hire or contract which are not actually used, all handling by company, affiliate, or subsidiary employees, transportation beyond the unloading point, operation and maintenance charges related to purchased power, and all costs included in base rates. It includes all other previously included charges relating to fossil fuels and the following charges, where not covered above, relating to the newly included energy sources:

Nuclear—fuel and fuel assemblies, fabrication cost, leased or rented storage, and transportation less salvage value.

Geothermal—unit price (by contract, where applicable) of steam plus effluent disposal cost.

Purchased Power—energy and capacity charges.

In addition, no interest charge will accrue to the amount in the balancing account, but a fixed one percent charge for local franchise fees and uncollectible expense will be allowed in each adjustment factor on the amount then found to be collectible or refundable. The cost of fuel oil to be reflected in the factor shall be determined by taking the recorded quantity of oil (in Btu's) used during the 12-month period, and costing it at the price of the inventory at the end of the period. All adjustment factors, in either direction, shall not be final without an express finding and order.

Miscellany

1. The Mono Power Company service charges shall be included in the eligible expenses for Edison, in accordance with the intent of the decision authorizing this charge.

2. The burden of proving reasonableness of fuel cost is on the utility.

3. Since the new clause includes all energy sources, including purchased hydroelectric power, it shall be renamed the Energy Cost Adjustment Clause (ECAC).

4. Each respondent utility, individually or collectively, shall submit a sample ECAC, conforming with this decision, within 20 days after the effective date. After such filing, and the filing of the recorded data discussed earlier, the staff shall recommend an ECAC which shall contain the base cost for each utility, together with the first six-month amortization of the

fuel collection balance of each utility, expressed in both total dollars, and cents per KWH. Notice requirements shall remain as at present.

Findings

1. The rates fixed as a result of the fca are not general rates, but specialized, extraordinary rates not created by or in a general rate proceeding.

2. The amount of over- or undercollection of fuel clause revenues compared to increased fuel costs should realistically be determined on an actual recorded basis from the birth of the fuel clauses through the latest available date. Consistent with our opinion on the sales to DWR and others, any recorded overcollection should include adjustment for past revenue loss related to those sales. SDG&E's Fuel Collection Balance should also be adjusted consistent with prior decisions regarding gains from the sale of fuel.[8]

3. Any difference in revenues and expenses, as computed under Finding 2, should be amortized in rates over a period not to exceed 36 prospective months, on an interim basis. Thirty-six months is a fair and reasonable initial time period over which to amortize such difference, without unduly burdening either the utility or the ratepayer, and the Fuel Collection Balance as of April 1, 1976 shall bear interest at the rate of 7 percent per annum.

4. In ordering a future reduction or increase of rates due to an over- or undercollection of revenues compared to increased fuel costs, on a recorded basis, under the fca, we are setting future rates because of existing financial inequities due to past performance.

[8] All respondents shall in the future promptly advise the Commission of such transactions and appropriately adjust energy costs.

5. The average-year forecast type of fuel clause does not accurately match fuel clause revenue with associated increased fuel cost. This is particularly true in the comparatively short term. This clause should be abandoned because of this inherent defect and because it generates controversy and litigation over the use of estimates and forecasts.

6. The fuel clause adjustment procedure is a reasonable device for protecting the utility against actual extraordinary increases in the cost of its single largest expense, on a dollar-for-dollar basis, and should be implemented in a reasonable manner to allow the utility to keep its operations viable, while not penalizing the ratepayer. This holds true even though the utility's incentive to keep fuel cost down is essentially vitiated by a fuel clause. The type of recorded fuel clause, now to be called the Energy Cost Adjustment Clause we have designed, as defined in Sections A, B, C, E, G, H, I, J, K, and L, supra, most fairly and adequately meets the objections to the existing fuel clause, the abolition of fuel clauses generally, and the balancing of the interests of the utility and the ratepayer, for the reasons set forth in the body of this decision. The matters covered under *Miscellany* should be included for specific respondents, where applicable.

7. The disclosure of fuel oil prices should be handled as set forth in Section F, supra.

8. The new ECAC is a reasonable alternative to the existing fca and should be adopted in this proceeding.

9. The burden of proving the reasonableness of all fuel prices and purchases is upon the utility. All ECAC filings must be made by application. Any appli-

cation seeking a rate increase will be set for hearing. Other applications may be determined without hearing if no special circumstances exist.

10. PG&E, Edison, and SDG&E have overcollected under their respective existing fuel clauses, while Sierra has undercollected, as set forth herein, but the actual amounts involved shall be determined after the filing of the data required under Finding 2.

11. Meteorological forecasting as it affects electric generation is not a useful tool for anything other than extremely short range periods, and is not necessary for the adopted ECAC, since it is a recorded basis clause not requiring forecasting.

12. The overcollection credit should be applied on a uniform cents-per-kwhr basis to all appropriate sales and the credit should be specified separately. The energy cost adjustment factor should be applied on a cents-per-kwhr basis only to sales above lifeline quantities.

Conclusions

1. Each respondent utility should file, within 20 days after the effective date of this order, (1) computations on an actual recorded basis indicating the amount of revenue collected and increased fuel cost experienced under its respective fuel clause, from its inception through the latest available date, all on the same basis documented in Exh. No. 13 as modified in Finding 2, and (2) a sample ECAC conforming with the requirements herein stated.

2. The staff should recommend: (1) an ECAC, and (2) the first Fuel Collection Balance amount for each utility and the first six-month amortization thereof.

3. All notice requirements should remain unchanged.

4. The setting of future rates to reflect past over- or undercollections is not retroactive ratemaking.

5. The future reduction of fuel clause adjustment rates is not retroactive ratemaking.

6. Because it is in the public interest to require at the earliest practical date the filings and disclosure herein we will make this decision effective on the date of signing.

ORDER

IT IS ORDERED that:

1. Each respondent utility, within twenty days after the effective date of this order, shall file:

a. Data indicating the amount of over- or undercollection of fuel clause revenue compared to increased fuel cost expense on an actual recorded basis from the inception of its respective fuel clause through the latest available date.

b. A sample Energy Cost Adjustment Clause (ECAC) conforming to the requirements and containing the elements set forth in this decision.

2. The staff shall:

a. Recommend a proposed ECAC conforming to the requirements and containing the elements set forth in this decision.

b. Recommend the amounts of over- or undercollection determined under respondents' respective fuel clauses through the latest available date.

c. Recommend a rate adjustment for each utility based on the determination in (b) above, and the date of the first scheduled ECA, in conformance with the determinations made herein, including interest.

3. We shall adopt by further order or resolution a new ECAC and shall determine the amount of over- or undercollection and proportionate rate adjustments for each utility.

4. All ECAs in the future shall be on an interim basis, unless otherwise ordered by this Commission.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 27th day of April, 1976.

D. W. HOLMES
President
LEONARD ROSS
ROBERT BATINOVICH
Commissioners

I will file a written dissenting
and concurring opinion.
/s/ WILLIAM SYMONS, JR.

I will file a written dissenting
and concurring opinion.
/s/ VERNON L. STURGEON

APPENDIX 1

LIST OF APPEARANCES

Respondent: John C. Morrissey, Malcolm H. Furbush, *Robert Ohlbach,* and *Kermit R. Kubitz,* Attorneys at Law, for Pacific Gas and Electric Company; Sherman Chickering, C. Hayden Ames, and *David A. Lawson,* Attorneys at Law for Chickering & Gregory; Gordon Pearce, Attorney at Law, John H. Woy, Stanley Jewell, Vice President and General Counsel, for San Diego Gas & Electric Company; Rollin E. Woodbury, Robert J. Cahall, *William E. Marx,* Dennis G. Monge, and *Richard K. Durant,* Attorneys at Law, for Southern California Edison Company; and *John Madariaga,* Attorney at Law, Ralph Cromer, Vice President Commercial Services, and Richard G. Campbell, Vice President and General Counsel, for Sierra Pacific Power Company.

Interested Parties: *Frank J. Dorsey,* for Office of the Staff Judge Advocate, Headquarters Sixth U. S. Army Presidio of San Francisco; *George R. Gilmour,* Attorney at Law, Eugene P. Coyle, and *Sylvia M. Siegel,* for TURN; Robert P. Will, and R. D. Twomey, Jr., Attorneys at Law, for The Metropolitan Water District of Southern California; *William S. Shaffran,* Deputy City Attorney, John W. Witt, and Manley Edwards, for the City of San Diego; Robert W. Erickson, for the City of Anaheim; *Gordon E. Davis,* and *William Booth,* Attorneys at Law, for Brobeck, Phleger, and Harrison; *William H. Edwards,* Attorney at Law, for California Farm Bureau Federation; *Steven R. Cohen,* Attorney at Law,

Lloyd Harvego, and Dean L. Hunt, for California Department of Water Resources; Thomas J. Graff, for Environmental Defense Fund; *Henry F. Lippitt, II,* for California Gas Producers Association; Richard C. Morse, for Atlantic Richfield Company; Joseph Byrne, for Union Oil Company of California; Peter H. Kruse, for Perta Oil Marketing Corporation; Richard T. Mulcahy, for Pacific Resources, Inc.; Thomas M. O'Connor, City Attorney, for City of San Francisco; Alexander Googooian, for City of Bellflower; Leonard Snaider, Deputy City Attorney, Robert Russell, and Manuel Kroman, for City of Los Angeles; Joe Westmoreland, for City of Riverside, Scott B. Johnson; Dave Johnson, and Larry Moss, for Sierra Club; Norman Elliott, Attorney at Law, for Enright, Elliott & Betz; Page Miller, for Electricity and Gas for the People; Gary H. Twisselmann, for Ford Motor Company; John R. Phillips, Attorney at Law, for Center for Law in the Public Interest; and William M. Pfeiffer, for Southern California Gas Company.

Commission Staff: *Peter Arth,* Attorney at Law, *John Johnson* and Kenneth Chew.

COMMISSIONER WILLIAM SYMONS, JR., Dissenting in Part and Concurring in Part

COMMISSIONER VERNON L. STURGEON, Dissenting in Part and Concurring in Part

While we can concur in the revision of the fuel cost adjustment clause from a forecast basis to a recorded basis, we dissent when the majority decides to exceed the law to order refunds.

The majority's illegal action can be characterized not only as short-sighted, but one-eyed:

—In ordering immense refunds by PG&E and Southern California Edison, immediate payouts will result, always popular in the short-term, but the utilities' financial ability for the long-haul work of providing electricity is unfairly impaired.

—In concocting its refund order, the majority indulges in unlawful retroactive ratemaking.

—In gazing back, moreover, it looks not at the total picture of overall company earnings—which the record shows were below authorized earning levels during the period in questions [*sic*]—but to the single expense area of fuels, known before hand to show a surplus when viewed in isolation.

Revision of the Method of Fuel Cost Adjustment

Existing arrangements under the fuel cost adjustment clause have been thoroughly examined in the case before us—experience with its operation to date has been accumulated, its benefits and defects argued, and alternative, reasonable methods have been proposed for the future.

Our basic method of regulating utilities over the decades in this state and across the country has been the average year forecast method, and the logic of that regulatory method was followed in properly adopting the present fuel cost adjustment procedure. However, we have long known that forecasting is not without its inherent problems, one of which is variation between the average year construct and the particular year which does occur. The virtue of the average year forecast method, is that the shareholder, not the ratepayer, is at risk if the year varies from the average normal year. Under the regularly adopted and valid fuel adjustment clause, these variations have occurred as the theoretical model would predict. That the actual weather variations for the first two years proved favorable to the utilities has led to a clamor to erase these results by hook or by crook.

Selection of the term "overcollections" to characterize the variation between average forecast year and actual experienced year which has by chance of weather turned out positive, introduces an emotional short-circuit into the analysis. "Overcollections" suggests that more than proper and authorized rates have been taken from the ratepayer, which is not the case. But misperceptions can have strong impact, and this misnomer has provided the drumbeat for the push to retroactively mandate refunds from the companies.

But putting aside the question of retroactivity for the moment, our experience with the fuel clause and changing circumstances since its inception do sufficiently support a revision of the fuel cost adjustment clause (FCA). Since the initial adoption of the FCA in 1972, we have experienced a dramatic decline in supply of natural gas, with a resulting swing to dependence

on oil. This, combined with the Arab oil cartel effect on oil prices, has driven the component cost of fuel for the utilities from 20% to nearly 50% of the total costs of doing business. Given such a weighty impact, there is substantial merit in revising the fuel clause adjustment to operate in the future on the basis of recorded data so that wide variations in revenue and expense can be reduced and the actual cost of fuel be more nearly tracked.

Retroactive Ratemaking

Major revision of the tariffs providing for a fuel cost adjustment clause is not, however, a license to engage in retroactive ratemaking, as the final ECAC constructed by the majority attempts.

In seeking to recapture all funds collected "from the birth of the fuel clauses" (Opinion p. [54], the majority attempts to turn the clock back as far as March 21, 1972, and nullify the finality of all rate change decisions rendered since that day to this.

It has often been observed that "hard cases make bad law." The majority seeks equalization by means of hindsight. But to permit adjustment by means of retroactive ratemaking wreaks havoc to the whole scheme of supervision of public utilities in California. No decision would ever be final, either for purposes of establishing definitely the current income of a utility or allowing prospective investors to reliably evaluate the underlying value of securities to be purchased. Nor could any firm opinions based on generally accepted accounting principles be given as to the utilities [*sic*] assets and income, when retroactive ratemaking is permitted. What judicial review of the Commission final orders could be had, when such orders would be subject

to reconsideration, manipulation or adjustment at some undetermined future date? The reasons for the prohibition of retroactive ratemaking are clear. With the uncertainty retroactive ratemaking invariably introduces, the cure is infinitely worse than the problem sought to be solved.

Nor is the Commission possessed of authority to invoke retroactive ratemaking. The controlling statutory authority is Public Utilities Code § 728 which reads in pertinent part:

> "Whenever the commission, *after a hearing,* finds that the rates or classifications, demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity, or the rules, practices, or contracts affecting such rates or classifications are insufficient, unlawful, unjust, unreasonable, discriminatory or preferential, the commission *shall determine and fix,* by order, the just, reasonable, or sufficient *rates,* classifications, rules, practices, or contracts *to be thereafter observed and in force.*" (Emphasis added)

The clear reading of this section states that rates are to be set prospectively. As this Commission stated succinctly in Decision 43145, *Pacific Telephone and Telegraph Company,* 48 Cal PUC 823, 836 (1949):

> "There are definite rules of law governing rate-fixing and this Commission is bound thereby. Broad and plenary as its authority may be to fix rates, it is not free to disregard cardinal principles of rate-fixing. There is no better established rule with regard to the prescription of rates for a public utility than the one that holds that rate-fixing may not be accomplished retroactively, unless some specific statutory or constitutional authority permits. Past deficits may not be made up by excessive charges in the future nor may past profits be reduced by disallowance to future operating expense."

For more extensive discussion, see also the instructive dissent of Commissioner William Bennett in Decision 67369, *Pacific Telephone and Telegraph Company,* dated July 26, 1962.

In *Pacific Telephone and Telegraph Company v. Public Utilities Commission* 62 C. 2d 634, 650 (1965) the Supreme Court of California provided clear instruction as to the import of Section 728 of the Public Utilities Code, stating that "this language is plain and unambiguous." The Court concluded

> ". . . that the Legislature has not undertaken to bestow on the commission the power to roll back general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a commission decision ordering a general rate reduction. . . ."

The Court reiterated its earlier declaration of principle, at page 652 that

> " 'The fixing of a rate in the first instance is prospective in its application and legislative in its character. Likewise the reducing of that rate

would be prospective in its application and legislative in its character.' (*Southern Pac. Co. v. Railroad Com.*, 194 Cal. 734, 739 [231 P. 28] see also *People v. Western Air Lines, Inc., supra*, 42 Cal.2d 621, 630.)"

Nor can the majority elude the prohibition against retroactive ratemaking by re-characterizing rate increases under the tariff provisions of the fuel cost adjustment clause as "specialized, extraordinary rates" (Opinion, p. [54], Finding 1). This would be contrary to the indication given by the Supreme Court of California in *City of Los Angeles v. Public Utilities Commission*, 15 C.3d 680, at pages 695-703, that clearly includes rate increases due to fuel cost adjustment clauses within the ambit of § 728.

Further, the majority can find no support for its retroactive ratemaking in its vague citation to *City of Los Angeles v. Public Utilities Commission* on page [43] of the majority decision. While commenting permissibly upon annual adjustments regarding tax depreciation reserves, the Court did not act to overrule its explicit direction that the Public Utilities Commission was bound to set rates prospectively.

Nor will such a result be contrary to equity in the case at hand. Evidence was introduced into the record showing that over the term of the current fuel cost adjustment clause, the utilities to be hurt by this order have not exceeded their lawful authorized rate of return. Indeed, the revenue short-falls due to "regu-

latory lag" or commission-induced "regulatory stall" have been enormous. If the majority were free to set rates retroactively, it should at least consider this bigger picture. It would be ironic that the fuel cost adjustment clause, legitimately introduced to enhance the position of the utilities in the financial community and to guard that their ability to function be not impaired, be turned around like a boomerang to cause these very deteriorations it was supposed to prevent.

/s/ William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner

/s/ Vernon L. Sturgeon
VERNON L. STURGEON
Commissioner

San Francisco, California
April 27, 1976

APPENDIX D.

Notice of Appeal to The Supreme Court of The United States (Filed August 3, 1978).

In the Supreme Court of the State of California.

SOUTHERN CALIFORNIA EDISON COMPANY,
Petitioner,
vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,
Respondents.

To the respondents, Public Utilities Commission of The State of California, D. W. Holmes, William Symons, Jr., Vernon L. Sturgeon, Leonard Ross and Robert Batinovich, the members of and constituting said Public Utilities Commission, and to Janice E. Kerr, Hector Anninos and Timothy E. Treacy, their attorneys:

NOTICE IS HEREBY GIVEN THAT the above-named petitioner Southern California Edison Company hereby appeals to the United States Supreme Court, from the final judgment of the Supreme Court of the State of California entered in this action on May 25, 1978 denying a petition for rehearing of that Court's decision filed March 23, 1978, affirming Decision No. 85731 dated April 27, 1976 of the Public Utilities Commission of the State of California.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph (2).

DATED: August 2, 1978.

O'MELVENY & MYERS
Everett B. Clary
Louise Nemschoff

By /s/ Louise Nemschoff

Attorneys for Petitioner
Southern California Edison Company

Rollin E. Woodbury
William E. Marx,
Of Counsel

(Certificate of Service omitted in printing.)

APPENDIX E.

Notice of Appeal to the Supreme Court of the United States

(Filed August 3, 1978).

Before the Public Utilities Commission of the State of California.

Investigation on the Commission's own motion into electric utility Fuel Cost Adjustment tariff provisions and procedures; and the changes, if any, that should be made to said tariff provisions and procedures. Case No. 9886.

To the Public Utilities Commission of the State of California, D. W. Holmes, William Symons, Jr., Vernon L. Sturgeon, Leona. l Ross and Robert Batinovich, the members of and constituting said Public Utilities Commission, and to Janice E. Kerr, Hector Anninos and Timothy E. Treacy, their attorneys:

NOTICE IS HEREBY GIVEN THAT Southern California Edison Company hereby appeals to the United States Supreme Court, from the final judgment of the Supreme Court of the State of California entered in *Southern California Edison Company v. Public Utilities Commission, et al.*, (S. F. Number 23500) on May 25, 1978 denying a petition for rehearing of that Court's decision filed on March 23, 1978, affirming Decision No. 85731 of the Public Utilities Commission of the State of California entered in the above-captioned proceedings.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph (2).

DATED: August 2, 1978.

O'MELVENY & MYERS
Everett B. Clary
Louise Nemschoff

By /s/ Louise Nemschoff

Attorneys for Southern
California Edison Company

Rollin E. Woodbury
William E. Marx,
Of Counsel

(Certificate of Service omitted in printing.)

APPENDIX F.

Petition of Southern California Edison Company for Rehearing and Reconsideration of Commission Decision No. 85731 and Petition for Stay

Before the Public Utilities Commision of the State of California.

Investigation on the Commission's own motion into electric utility Fuel Cost Adjustment tariff provisions and procedures; and the changes, if any, that should be made to said tariff provisions and procedures. Case No. 9886. Filed March 6, 1976.

Petition

Pursuant to Section 1731 of the Public Utilities Code, Southern California Edison Company ("Edison"), because of its conviction that the decision is factually and legally unsound, is inequitable, inconsistent, arbitrary, capricious and ambiguous, respectfully petitions the Commission for rehearing and reconsideration of its Decision No. 85731 ("the Decision") upon each and all of the grounds hereinafter discussed.

PRELIMINARY STATEMENT OF ERRORS

First, and most importantly, the Commission's order is unlawful because it constitutes retroactive ratemaking. Specifically, it violates Section 728 of the Public Utilities Code, which has long been interpreted by the California Supreme Court to forbid retroactive adjustments of formally adopted

rates once they become final. *Pacific Telephone & Telegraph Co. v. Public Utilities Commission*, 62 Cal.2d 634, 650 (1965); *City of Los Angeles v. Public Utilities Commission*, 7 Cal.3d 331, 356 (1972).

The Commission acknowledges, in its order requiring retroactive rate adjustments, that all revenues Edison is being required to return were collected under rates formally approved by the Commission and expressly found to be just and reasonable (the Decision, p. 3). Nevertheless, it purports to distinguish prior decisions by the California Supreme Court on the original and novel ground that the rates involved there had been set pursuant to "general" rate proceedings, whereas here they were set pursuant to "special" rate proceedings. However, this purported, but manufactured, distinction finds no support in the law. As the dissenting Commissioners correctly point out, it is directly contrary to the determinations of the California Supreme Court in *City of Los Angeles v. Public Utilities Commission*, 15 Cal.3d 680, 695-97 (1975) that such rate decisions, concerning what the Commission characterizes as special rate provisions like a fuel cost adjustment clause ("fca"), fall within the ambit of Section 728. Consequently, the prohibition against retroactive ratemaking in Section 728 precludes the action here taken by the Commission.

Second, the Commission's order is inequitable because it ignores its own prior determination of a reasonable rate of return on Edison's investment. This is not a case where excessive revenues have been obtained. Rather, as hereinafter more fully developed, for the entire period under investigation, Edison's rate of return averaged significantly *less* than the *minimum* reasonable rate of return authorized by the Commission, even including the revenue which the

Commission describes as "overcollections" under the fca. As the dissenting Commissioners again correctly point out, past revenue shortfalls due to "regulatory lag" have been enormous. The Commission's current order would further reduce Edison's net income and further jeopardize Edison's legitimate capital needs.

Despite the fact that it would be both appropriate and reasonable for the Commission to consider Edison's rate of return during the period in question before taking the extraordinary and unlawful step of ordering a retroactive rate adjustment, the Commission brushes aside without comment all of the evidence on this subject. The Commission's refusal to take this fundamental consideration into account has resulted in an order which plainly is inequitable and shortsighted, as well as unlawful, the Commission's failure to provide any statement of reasons why rates of return should not be so considered constitutes a clear abuse of discretion and a failure to make appropriate findings on a material issue, as required by Section 1705.[1]

Third, the Commission's order is inconsistent with the rationale stated in its supporting opinion. Specifically, the order fails to observe the Commission's own purported distinction between "general" and "special" proceedings in determining the total amount that Edison is to be required to refund to its customers. Under such distinction advanced by the Commission, "overcollections" attributable to Edison's base rates would not be refundable; only those attributable to the fca component would be. Yet more than half of the

[1]Findings of fact and conclusions of law on all material issues are expressly required by the 1961 amendment to Section 1705 (Stats. 1961, ch. 1118, § 1, p. 2843). This is a jurisdictional requirement for an effective decision of the Commission. *Northern Cal. Power Agency v. Public Utilities Com.*, 5 Cal.3d 370, 380-81 (1971).

alleged "overcollections" made subject to the refund order are improperly attributed to the fca component and should have been attributed to the base rates. The fact that fca adjustments were "folded into" Edison's base rates in 1973 in connection with a "general" rate proceeding demonstrates the inconsistency of the Commission's failure to recognize this distinction even under its own theory.

The Commission's order also is inconsistent in its adoption of a recorded-year test to measure the performance of the fca when the Commission expressly designed the fca to track fuel costs on an *average-year* basis.[2] Even the Staff witness agreed that an average-year test was the appropriate test.[3] In addition, under the original order the fca's performance was to be judged by whether the resulting rate of return fell within the range previously determined by the Commission to be reasonable.[4] The Commission now abandons this measure of performance without any findings as to why it should be cast aside.

Fourth, the Commission's current order would further seriously adverse Edison's financial ratings and its ability to raise capital required to maintain adequate electric utility service, and is unlawfully confiscatory.

Fifth, the Commission's order is also arbitrary and capricious in its inappropriate retroactive application of a recorded test which includes only part of the components included in its proposed new Energy Cost Adjustment Clause (ECAC) which is supposed to be a recorded basis. The

[2]In resolutions approving increases in Edison's fuel cost adjustment billing factor, the Commission expressly referred to this criteria (e.g., Resolutions No. E-1388 and No. E-1414 dated May 7, 1974 and November 13, 1974, respectively.

[3]Johnson, Tr. 736-7, 757.

[4]Decision No. 79838, pp. 7 and 12.

Commission recognizes, in constructing its new ECAC, that it would be inequitable to pass through fossil fuel cost increases on a recorded-year basis and not to pass through offsetting cost increases for other energy sources, including purchased hydroelectric power and nuclear power. Its new cost adjustment clause permits *all* such increases to be passed through in future years. However, while the Commission seeks to impose retroactively the burdens of a test of the existing clause on a recorded basis similar to the recorded-year features of the new clause with respect to fossil fuel, it appears unwilling to apply the same principle to purchased hydroelectric power and nuclear power. The Commission arbitrarily, and without explanation, refuses to permit Edison to take into account recorded cost increases for these other power sources in calculating the total of the supposed "over-collections" Edison, under the Commission's order, is to be required to refund. If the retroactive application of such tests were applied consistently, and not selectively, that total would be reduced substantially. If the concept of adjusting future rates for past over or under collection of revenues were to be adopted, in the case of Edison, the adjustment to future rates would require a substantial increase because of large earnings deficiencies experienced in the past.

Finally, as hereinafter shown, there are a number of additional errors and ambiguities of major dimensions which render the Decision defective and improper.

UNDISPUTED FACTS

The record relating to the fuel cost adjustment ("fca") tariff provisions establishes beyond dispute, as indeed is clearly recognized in the Commission's Decision No. 85371, the following facts:

(a) The authorized filed tariff providing for the fuel cost adjustment provided for such adjustments to be made on a forecast 12-month period predicated upon average-year conditions of temperature and precipitation (p. 5 of the Decision), as is the case with the other filed tariffs (p. 8 of the Decision), and have been operating as designed (p. 1 of the Decision).

(b) The fca was originally adopted because in an inflationary period, with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so its ability to function is not impaired (p. 3 of the Decision), and if a fuel offset proceeding is to achieve its primary purpose, which is to forestall a general rate case which would probably lead to even greater increases, the proper criterion for determining whether to grant or deny the increase is the effect on the previously found rate of return. *Southern California Edison Company*, D. 79838 dated March 21, 1972, 73 Cal.P.U.C. 180 (cited on page 3 of the Decision).

(c) The fuel adjustment billing factors resulting from the fca tariffs were each authorized, after review and related findings as to their appropriateness by resolution of the Commission, after proper filings made by Edison (p. 3 of the Decision).

(d) Edison filed with the Commission, as required by Decision No. 79838, its annual reports on the previous year's

recorded and adjusted operations, which reflected on such bases resulting rates of return on its system for such periods (Ex. 9B; Decision No. 79838, p. 18; and p. 4 of the Decision).

(e) Weather conditions which will be experienced cannot be accurately predicted for 12 months or more in the future (p. 6 of the Decision).

(f) Under the average-year ratemaking basis, utilized by the Commission in fixing utility rates in California, such as Edison's, and including Edison's fca, it is recognized that in a nonaverage wet year, more hydroelectric power is generated and the requirements for fuel are diminished and that fca in such nonaverage wet year will generate more revenue than the expense actually incurred under average-year conditions (with the reverse being true in nonaverage dry years) (p. 5 of the Decision). Such ratemaking basis is predicated upon the theory that over an extended period of time the nonaverage wet years are averaged out by nonaverage dry years (p. 5 of the Decision).

(g) Since the enactment of Edison's fca there have been experienced above average wet years (p. 5 of the Decision).

(h) All moneys generated by the fca were lawfully collected (p. 10 of the Decision).

ARGUMENT

A. *The Commission's Decision Constitutes Unlawful Retroactive Ratemaking*.

The Commission, in promulgating its Decision No. 85731, is acting under authority conferred on it by the Legislature by Public Utilities Code § 728 to modify rates (the fca) charged by a public utility found by the Commission to be

unjust and unreasonable and to determine the just and reasonable rates (the ECAC) to be thereafter observed and in force. Clearly, the Commission's action, insofar as it goes beyond a change in the fuel clause adjustment procedure for the future and provides for future reductions of final rates expressly approved by the Commission "because of existing financial inequities due to past performance" (the Decision, p. 21), violates Section 728 of the Public Utilities Code, which has long been interpreted by the California Supreme Court to forbid retroactive ratemaking. *Pacific Telephone & Telegraph Co. v. Public Utilities Commission*, 62 Cal.2d 634 (1965) (See also: Dissenting Opinions of Commissioners Bennett and Mitchell in this telephone case in the PUC decision below, 62 Cal.P.U.C. 775 at 880 and 886, from the retroactive aspects of the order which were subsequently annulled by this Court); *City of Los Angeles v. Public Utilities Commission*, 7 Cal.3d 331 (1972).

While stating that all of the moneys generated by the fuel adjustment clause were lawfully collected (p. 10 of the Decision), the majority, upon unsupported and specious grounds, improperly and transparently attempts to circumvent the law prohibiting retroactive ratemaking, although it purports to recognize that retroactive ratemaking is prohibited under California law.

1. The majority finds rates fixed by the Commission pursuant to the fuel clause adjustment are "specialized, extraordinary rates" and not "general rates", so that the Commission is somehow, by such classifying, empowered to reduce rates prospectively because of the past performance of a tariff provision even though the past revenues were derived under rates which were lawfully and finally effective. This is manifestly erroneous and unlawful.

a. The attempt to distinguish the applicability of the law against retroactive ratemaking as between utility tariffs authorized in proceedings labeled "special or extraordinary" and tariffs authorized in proceedings labeled "general" finds no support in the law. Quite to the contrary, as the dissenting Commissioners properly pointed out, the California Supreme Court determined just a few months ago that changes involving tariffs providing for formula rate adjustments similar to fuel clause adjustments in this proceeding are governed by Section 728 of the Public Utilities Code, *City of Los Angeles v. Public Utilities Comm.*, 15 Cal.3d 680, 696 (1975). In holding that Section 728 permits the Commission to use an annual adjustment clause, the Court in that case expressly rejected the argument "that a 'rate' [within the meaning of Section 728], is a single set of unvarying fixed charges." *id.* at 695. Since there is, of course, no question that rate changes pursuant to Section 728 may not be applied retroactively, *Pacific Telephone & Telegraph Co. v. Public Utilities Commission, supra*, 62 Cal.2d 634, 650 and 654; *City of Los Angeles v. Public Utilities Commission, supra*, 7 Cal.3d 356, the majority's decision is clearly unlawful.

This result is made even clearer by the Court's further holdings in the *Pacific Telephone* case, *supra*, that the legislative scheme permits refunds only in the circumstances provided in Section 1766 and not otherwise and that Section 734 reinforces the prohibition against orders to refund collections made pursuant to rates formally found reasonable by the Commission. The Commission, of course, has not purported to, and could not, base its decision on Section 1766.

b. Nor can it be argued that there is any difference between a refund order based on past lawful collections and a euphemistic concept of a "prospective rate adjustment based

on past performance". The fact is that the past performance to which the majority refers is simply the past lawful collection of revenues under the rates approved by the Commission, including the fuel clause adjustments. As the dissenting Commissioners correctly pointed out, the Commission itself has recognized that "[p]ast deficits may not be made up by excessive charges in the future *nor may past profits be reduced by disallowance to future operating expense.*" *Pacific Telephone & Telegraph Company*, 48 Cal.P.U.C. 823, 836 (1949) (emphasis added). That principle clearly controls this case. Just as past losses cannot be used to support a claim that rates for the future are confiscatory, neither can past earnings be properly used to reduce rates in the future below what would otherwise be just and reasonable. Cf., *Board of Public Utility Comm. v. N.Y. Tel. & Tel.*, 70 L.ed. 808, 812-813 (1926); U.S. V. PUC of D.C., 58 F.2d 533 (1946).

c. The specious nature of the attempted distinction profferred by the majority is clearly reflected in the fact that from the start (as recognized elsewhere in the Decision) Edison's base rates have included a fuel component, and at one time the accumulated fuel adjustments under the fuel clause up to that time were folded into the base rates so that the fuel adjustment would start again from zero (Appl. No. 53488, Dec. No. 81919, dated September 25, 1973, 100 PUR 3d, 257). Historically, before the time the fca was first authorized, the then existing base rates included a fuel cost component of approximately 3 mils per kilowatt-hour; subsequent to the authorization of the fca and before the decision in Edison's general rate case in 1973, there were six adjustments in the fuel clause adjustment factor which culminated in an fca factor at the time of such decision of 3.08 mils per kilowatt-hour. At the time of said decision in 1973, the said

3.08 mils was folded into the base rates authorized in that decision and the fuel cost adjustment factor was returned to zero; thereafter, at three-month intervals through November 1974, an adjustment was made in the fuel cost adjustment factor to cover increases above the fuel cost component that had been folded into the base rates to cover fuel expense. Thus, at the times covered by the test, a part of the fuel expense was attributable to revenues from base rates and a part to revenues from the subsequent fuel cost adjustment factors.

d. The court decisions referred to in the Commission's Decision are not supportive of the position of the majority on the point. The case of *City and County of S.F. v. PUC*, 6 Cal.3d 119, did *not* involve a situation where telephone rates had been made lawful and finally effective by a decision of the Commission which had become final. The PUC decision under review in this Supreme Court *PT&T* case, relied upon by the majority of the Commission, was an interim decision that was being reviewed and had *not* become final. The action by the Court in this *PT&T* case provides no authority supportive of a position that "When we find overcollections we have the option of reducing rates or the rate of return" (the Decision pp. 10-11) as to rates established by Commission orders no longer subject to court review. In fact, this distinction between rates which have become lawfully and finally effective and those which had not become final and lawful is specifically discussed by the California Supreme Court in the other case referred to by the majority in this connection; i.e., *City of Los Angeles v. PUC*, 15 Cal.3d 680, filed December 12, 1975, pp. 695-7.

2. Any attempt so to retroactively affect the revenues heretofore collected under lawful and final rates which have

properly become the property of the utility would deprive Edison of its lawful rights under both the federal and state Constitutions by denying it equal protection of the laws and by taking its property without due process of law (cf., *Board of Public Utility Comm. v. N.Y. Tel. & Tel.*, 70 L.ed 808).

B. *Commission Applies Improper Test To Develop Its Alleged "Overcollection"*.

In its determination that there has resulted overcollections alleged to have arisen from the performance of the existing fuel adjustment clause, the Commission has erred by applying an improper test.

1. While recognizing that the existing fca was a tariff designed on an average-year basis, as in the case with Edison's other tariffs, and was designed to relate to average-years' revenues and average-years' expenses, the Commission adopts an improper test of the past performance of the fca, i.e., a test based upon recorded fuel expenses in nonaverage years, to develop its alleged overcollection (as distinguished from testing to decide if for the future the Commission should adopt a new or modified fca). The test it applied is contrary to the testimony presented on behalf of its own technical staff (Johnson, Tr. 736-7, 757), as well as that of the utilities (e.g., Codd, Tr. 488-9), to the effect that the evaluation of the performance of present fuel clauses should be on an average-year basis since this is how they were designed (p. 6 of the Decision).[5] Furthermore, there is no

[5]The Commission expressly recognized this test in applying Edison's fca on a number of occasions, e.g., in Resolution No. E-1388 issued May 7, 1974, at page 3, it stated the purpose of the fuel clause to be "to offset increased fuel costs on an average-year basis without allowing for any reduced revenues, other increases in operating expenses, or for increasing the level of the utility's rate of return." See also Resolution No. 1414 dated November 13, 1973, p. 3.

evidence in the record which would support the Commission's adoption of a recorded results basis for testing the past performance of the existing fuel clauses for purposes of determining whether retroactive adjustments should be made.

2. A proper test of the past performance of the fca, i.e., testing how well it performed for what it was designed to do, does not indicate overcollection of revenues (rather, it develops a significant revenue deficiency).

a. As recognized in Decision No. 85731, the various utility witnesses, as well as the Staff witness, concluded that the evaluation of the present fuel clauses should be on an average-year basis since this is how they were designed. A test made by Edison on this appropriate basis is shown by the record to produce a significant undercollection (Ex. 37, pp. 3 and 4).

b. One might have supposed that the fairness of the aforesaid concept would have been readily recognized by all. Not so. The majority of the Commission rejected such test, and while purportedly determining the appropriateness of the past performance of the fca by testing its short-range period conformity to recorded fuel expenses, in an admittedly nontypical situation, and, developing thereby alleged overcollections from the fca, erroneously concluded that "Therefore, we think it is reasonable that to determine whether or not the fuel clause performed *as anticipated*, it must be measured on an actual or recorded basis." (emphasis added) (the Decision, p. 8).

1) If by "as anticipated" it is intended to be suggested that it was anticipated that the fca on an average-year basis would track recorded amounts in wet years, the assertion is

inconsistent with the majority's dissertation on this phenomenon on page 5 of the Decision and is obviously fallacious.

2) If by "as anticipated" it is intended to refer to its subsequent indication on page 12 that "all the parties agree" that the purpose and intent of the fuel clause is to match increased fuel costs with increased revenues on a dollar-for-dollar basis — in nonaverage wet years — it is equally inconsistent and fallacious.[6]

c. In rejecting the more appropriate test (cf., Resolution No. E-1388 dated May 7, 1974, p. 3; Resolution No. E-1414 dated November 13, 1973, p. 3) for purposes of determining if the utility has overcharged its customers, the majority retroactively changes the test of fuel clause performance. The majority asserts that the "real world" does not use average-year bases and makes a somewhat less than complete, as well as misleading, reference to Edison's 1974 annual report to its shareholders (Ex. 21) while pointing out that other utilities' shareholder reports reflected their earnings in the same way (p. 8 of the Decision). Any implication that Edison's annual report did not disclose the nonaverage year and nontypical nature of its 1974 recorded earnings to its shareholders is grossly misleading and inaccurate.[7]

[6]It is appropriate to observe that the assertions in the majority opinion as to what was "anticipated" or "originally intended" by fca are made by two who became Commissioners two years after it was authorized and by one who dissented from such authorization (Dec. 79838, p. 18). Cf., Dissenting Opinion in this proceeding by two Commissioners who were there, at p. 2.

[7]With reference to the $4.10 earnings reflected in the Company's 1974 Annual Report to Shareholders which is adverted to in the Decision, the report stated: "These results, however, should be viewed in perspective. The increase in earnings is attributable almost entirely to unusually favorable weather conditions — record rainfall — which made available more lower-cost hydroelectric power, and the availability of more natural

(Footnote continued on next page)

d. The utilities have been required to make, and have made, reports to the Commission, for its use in monitoring performance of such tariffs, which reflected results of their operations and rates of return upon *both* recorded and average-year bases.

In the "real world", we submit, the bottom line for evaluation of California utilities is the rate of return effectively authorized by the Commission and the likelihood of its realization, which represents the life blood for such utilities since it translates into prospects for future earnings (cf., In re *Public Service Company of New Mexico*, New Mexico Public Service Commission Case No. 1196 — Decision issued April 22, 1975; Re *Utah Power & Light Co.* Case No. 7167 — Decision issued March 4, 1976). This is of far greater importance to the "real world" interests of shareholders, security analysts and financial institutions *than past recorded earnings under unusual or nontypical conditions*.

1) In this connection, the record shows that on an average-year basis during the entire period involved Edison did not earn the rate of return last authorized by the Commission as the *minimum* reasonable rate of return (Ex. 9B, pp. 4 and 5; Tr. 458, et seq.).[8]

2) The record also shows that, despite unusually favorable nonaverage-year conditions during most of the period, even on a recorded basis, Edison's rate of return averaged

gas than had been anticipated. Such extraordinary conditions cannot be counted on to recur in 1975 and, consequently, earnings for 1975 are expected to be substantially less." Similar qualifications appear elsewhere in such Annual Report and in the prospectuses utilized in connection with the sale of the Company's securities during such periods.

[8]Edison's report to the Commission dated March 30, 1976, showed Edison's rate of return for California jurisdiction, on an average-year basis, for 1975 to have been 5.69%, which was well below the 8.2% *minimum* level authorized by the Commission in Decision No. 81919.

less than such minimum reasonable rate of return for the entire period involved of almost 4 years. In other words, while on a recorded basis fossil fuel costs were not as much, the difference was more than offset by other increased recorded costs and/or revenue deficiencies.

C. *Decision Erroneously Applies the Test It Purports To Use.*

1. Not only does the majority, in the Decision, apply an improper test, as aforesaid, they do not correctly calculate or measure the test which they purport to apply, with resulting significant distortions and errors that improperly inflate the alleged overcharge (which we understand the Staff presently estimates to be approximately $140 million as of April 1, 1976).

a. In purporting to apply an actual or recorded test basis, the Commission recognized (pp. 5 and 7 of the Decision) that during the period involved there was increased purchased power,[9] which had the effect of reducing recorded fossil fuel expense, but it ignored the correlative and offsetting increased costs of purchased power above those covered by the base rates.

The only apparent reason for such exclusion was that such purchase was of hydroelectric power which was not "fuel" within the meaning of the fuel clause tariff. Such reasoning, however, is fallacious in undertaking to apply a *test* of the operations under the fca upon what purports to be a recorded basis for purposes of determining if customers have been overcharged because such correlative and offsetting added expense of purchased power must be included to have an accurate and fair comparison. Similarly, in applying such

[9]Available principally from the Pacific Northwest.

test, the Commission's method ignores the costs of greater availability of nuclear energy which similarly (though not to the same extent) reduced fossil fuel expense during the period involved (Tr. 370, et seq; see also Ex. No. 37, pp. 9 and 10). These discrepancies are estimated, as of August 31, 1975, to be $43 million of the alleged overcharge and as of April 1, 1976, to be $71 million.

b. In purporting to apply an actual or recorded test basis, the Commission improperly excluded franchise fees and uncollectible expenses associated with gross fca revenue (Tr. 370 and Ex. No. 37, pp. 11 and 12, and Tr. 1112).

As of August 31, 1975, this exclusion alone is estimated to constitute $7 million of the alleged overcharge and to be $10 million as of April 1, 1976. The results of such exclusions involve a patently inappropriate allocation of *all* of the franchise fees and uncollectible expenses, which are a function of gross revenues, to gross revenues associated with the base rates, whereas such expenses are similarly affected by gross revenues generated by the fca. Clearly, the more appropriate formula would be to reduce fca revenues by the amount of franchise fees and uncollectible expenses *attributable thereto*.

Note: In connection with the aforesaid discrepancies, the Commission, in its proposed modification of the fuel adjustment clause procedures, has undertaken to correct *for the future* each of the errors reflected therein.

c. In purporting to apply an actual or recorded test basis, the Commission improperly attributes all of the jurisdictional fuel and purchased power revenue expense differential, which resulted during the period involved from nonaverage-year conditions, to the fca, rather than allocating the differential between base rates and the fca, because, under this concept, the fuel cost component in the base rates (which, like the fca, was developed under the traditional California ratemaking concept of average-year conditions) would, under such test, have produced similar "overcollections" and a portion of such alleged overcollections would be attributable to base rates (Tr. 452-3, 473, et seq; Ex. No. 37, pp. 5 and 6, and Tr. 1112).

If the alleged overcollections of $140 million were to be allocated between base rates and fca revenues on the basis of the revenue relationships reflected in Ex. 38[10] and a percentage of 53% were applied to base rate revenues attributable to fuel expense, the amount attributable to this discrepancy so calculated is $79.5 million, as of April 1, 1976.[11]

d. The unsoundness of the rejection by the Commission majority of Edison's contention that revenues less expense differentials generated by fca should be distributed or allocated between fca revenues and revenue generated by the fuel component in base rates ignores the fact that the Commission ordered base rates designed to recover the total cost of fuel for the test period and accordingly reset the fca to zero in its Decision No. 81919 issued in October 1973 in Application No. 53488.

Even though the fuel adjustment billing factor had been reset to zero, the majority does not recognize that a portion of

[10]Application of the relationships reflected in Exhibit 38, Table 1, Sheet 1, results in a 53% amount attributable to base rates. While this precise percentage may not be applicable to the Commission's reported $140 million figure, clearly, some substantial portion of said amount would be attributable to base rate revenues if any such recorded test of performance were to be applicable.

[11]The aggregate of the measure of these errors would not be the sum of the figures developed in subparagraphs (a), (b), and (c) since, among other things, the individual items are not independent variables.

the alleged overcollection is assignable to the base rates. Consider for example, if the fuel prices had not increased above the level which was used in establishing the base rates in October 1973, the fca billing factor would have remained at zero, therefore, no revenues would have been collected under the provisions of the fca after that date. Under favorable wet year conditions, however, the fuel component of base rate revenues would have exceeded fuel expense on a recorded basis, resulting, under the Commission's treatment, in an alleged overcollection which the majority apparently would attribute to the fuel adjustment clause even though no fuel clause revenue was being collected.

Stated even more fundamentally, it is clear that if there were no fuel clause all of the fuel-cost-related revenue-expense differential would be clearly attributable to the base rate revenues; on the other hand, if the fuel clause were designed to recover all of the fuel expense, all of the fuel-cost-related revenue-expense differential would be attributable to fuel clause revenues. This shows not only the inequity of the test being utilized by the Commission for purposes of determining the alleged overcollection, but also the speciousness of the majority's attempted distinction between "general rates" and rates resulting from "special" or "extraordinary" proceedings, such as the fca, in attempting to circumvent the clear legal bar to retroactive rate adjustments.

e. In this connection, the record reflects Edison's showing that, under the average-year test which all of the technical witnesses testified would be the proper test for such purpose, as recognized by the majority (p. 6 of the Decision), there was an undercollection by Edison for the years involved through August 1975 aggregating $99 million (Ex. 37, p. 4, and Ex. 38, Table 1).

D. *There Is No Proper Basis For Determining An Overcharge.*

The majority improperly rejects any consideration of the fact that during the period involved Edison did not earn even the *minimum* authorized rate of return, specified in its last general rate case, on an average-year basis or even on the average of the recorded experience during the period involved.

1. As noted earlier, in authorizing Edison's fca, the Commission, in its Decision No. 79838, which rejected a contention that other cost of service changes, such as tax reductions, should be taken into account when considering fuel cost changes, stated:

> "However, if a fuel cost offset proceeding is to achieve its primary purpose, which is to forestall a general rate case which would probably lead to even greater increases, the proper criterion for determining whether to grant or deny the increase is the effect on the previously found reasonable rate of return. Within this concept . . . reduced tax expense is considered to determine if the fuel cost increase will cause Edison to earn more than the lower range of rate of return previously authorized by this Commission; . . ."

When the fuel clause was instituted, Edison was ordered to file annual results of operations reports reflecting recorded and adjusted operations with the fca which include rate of return results on average-year and recorded bases. For the 1972-1975 period the weighted average rates of return calculated using the data from these reports are 7.71% on a

recorded basis and 6.73% on an average-year basis,[12] which may be compared with an 8.2% authorized rate by Decision No. 81919 dated September 25, 1973, as the minimum of the range of reasonableness for the test year 1973.[13]

2. Edison's fca tariff, as authorized by Decision No. 79838, contained no provision or condition or any consensual understanding which would justify a Commission order for refund or for any prospective adjustment in the future for past performance of its fca, and each revision of the fca amount was duly authorized by a Commission Resolution after a showing by Edison and review by the Commission's Staff (Ex. 9B, p. 8; Dec. Nos. 79838 and 81919; Res. Nos. E-1327, E-1344, E-1352, E-1359, E-1366, E-1377, E-1384, E-1388, E-1402 and E-1414). If any such provision or condition had been in the clause, the projected impact would have been serious enough to justify earlier or greater general rate increase requests, contrary to the stated primary purpose of the fca procedures.

[12]Edison's rate of return on a recorded and average-year basis as shown in the monitoring reports filed with the Commission, and minimum reasonable return, as found by the Commission in Decisions Nos. 78802 and 81919, were as follows:

Year	Recorded Rate of Return	Average-Year Rate of Return	Minimum Reasonable Rate of Return
1972	7.17%	7.20%	7.7%
1973	7.40%	7.27%	8.2%
1974	8.85%	6.90%	8.2%
1975	7.35%	5.69%	8.2%

[13]The reasonable range of rate of return of 7.7% to 8.1% was adopted by the Commission in Decision No. 78802 in Application No. 52336 for test year 1972.

3. The majority opinion suggests that, had the weather conditions obtaining been reversed and resulted in what they term an undercollection, the utilities would have applied for relief (p. 12 of the Decision). For over 50 years Edison has not requested emergency rate relief due to the adverse effects of intervening dry-year conditions, including such extraordinary periods as 1960 and 1961. If this portion of the majority opinion is intended to suggest either that, under such circumstances, the Commission would not have considered the rates of return reflected in the results of operations reports or that Edison would have been guaranteed relief in years of serious dry conditions, it is contrary to our experience (cf., *Southern California Edison Co.*, 25 CRC 475 (1924)) and contrary to the Commission's repeated observations that utilities are not guaranteed a return (e.g., *Citizens Utilities Co.*, 52 Cal.P.U.C. 637, and 72 Cal.P.U.C. 181; *General Tel. Co.*, 69 Cal.P.U.C. 601; *Oakland Key System Transit Lines*, 52 Cal.P.U.C. 779). Cf., Dissenting Opinion of Commissioner Bennett on retroactivity issue, 62 Cal.P.U.C. 880 at 884 in *PT&T* case, in which the California Supreme Court later annulled the retroactivity ordered by the PUC.

4. In this connection, it may be pointed out that, although Edison's annual reports to shareholders have never reported revenues and expenses of any kind on an average-year basis, its rates have never been established on a recorded basis. The Commission has heretofore consistently tested and fixed Edison's rates on an average-year basis.

E. *Refund Order By Commission Would Be Unlawful, Unfair and Unsound Regulatory Policy.*

It seems clear from the foregoing that the refund order contemplated by Decision No. 85731 would be unlawful. It should be equally clear that such an order would be highly

unfair and inequitable from the shareholders' standpoint. Clearly, the ratepayers have not been charged rates which were in excess of a just and reasonable level as demonstrated in the foregoing and there is no record evidence to the contrary.

What may not be so apparent, although it should be to the Commission and its Staff in their exercise of continuing surveillance over Edison's operations and in connection with its pending general rate case, is that a refund order of the type and magnitude contemplated by Decision No. 85731 would have a severe impact on Edison's financial standing in the eyes of the investment community, including the rating agencies (e.g., Tr. 295-6). Any such order by the Commission at this time would greatly increase the risk of a derating of Edison's securities at a time when such rating is already in serious jeopardy and when quality ratings on investment securities are perhaps more important than at any time in the past in terms of holding down the cost of new money and, even more importantly, the need to maintain as wide a market for Edison's securities as is reasonably possible. The compelling need to maintain the market for Edison's securities is readily apparent from even a cursory review of Edison's projections of new capital requirements to finance its ongoing construction program projected at nearly $500 million or more per year for the next few years. Such increased expenditures are the result of a combination of factors which include: (1) the effects of inflation upon construction costs, as compared with existing plants; (2) expensive environmental requirements for new and existing facilities; and (3) the increasing emphasis on nuclear and coal generating resources for the future to reduce Edison's reliance on exceedingly expensive foreign-sourced low-sulphur fuel oil required for air pollu-

tion control and to assist in the nation's quest for increased energy self-sufficiency. The higher capital requirements attributable to those two types of generating resources are widely recognized within the industry and among regulators, and are certainly familiar to this Commission. These include, in the case of nuclear, costs resulting from the relatively high capital costs normally associated with nuclear generation, and in the case of coal plants, the high capital costs associated with mine-mouth generation, due to severe environmental requirements, together with the large costs associated with the long extra high voltage transmission lines from remotely located plants to the load center. A refund order as contemplated by Decision No. 85731 would have a particularly devastating effect on Edison's ability to successfully manage its huge financial requirements in the future, and the increased costs of capital inevitably resulting from any such derating will ultimately have to be borne by the ratepayers as part of the cost of service. Furthermore, the resulting decreased cash flow would require increased external financing under adverse circumstances.

As recognized by the dissenting Commissioners, to permit such adjustments by means of retroactive ratemaking could wreak havoc to the whole scheme of supervision of California utilities.

F. *The Criteria Specified For the Modified Fuel Adjustment Clause Are Believed To Be Defective.*

1. As demonstrated by Exhibit A, attached hereto and made a part hereof, the effective charges under the type of new clause reflected in Decision No. 85731, based on historical data for the 1972 through 1975 period, indicate substantial continuing undercollections if such new clause had been

in effect during such period even with the inclusion of the balancing provision.

2. Similarly, such type of new clause, if applied in the future, would be expected to prevent the utility from being made whole. Applying such new type clause, since it would require Edison to base its energy cost adjustments on its consumption over a past 12-month period, is like asking a housewife to base her growing budget for a growing family upon the family's last year's level of food consumption.

3. The Commission, perhaps inadvertently, has stated in Finding No. 12 (p. 22 of the Decision) that in the future the adjustment factor should be applied only to sales above "lifeline quantities". This would effectively reduce Edison rates for lifeline quantities by 0.949¢ per kilowatt-hour, the present fuel cost adjustment billing factor. Such a reduction would impact Edison's revenues by more than $65 million per year unless offset by other rate increases. There is absolutely no support in the record for any such finding and conclusion and, we submit, such a result would be unlawful.

G. *The Decision Is Erroneous, Ambiguous Or Uncertain In Each of the Following Significant Respects and Should Be Corrected or Clarified.*

1. The Decision is not clear in establishing the intended period of lag between the recorded period and the effective date of the new ECAC. It does not state what period is to be used relative to the effective date of billing factor revisions under the new clause.

2. The determination of the period for which the price of various energy elements are intended to be included in the development of the ECAC is not clear. It does not indicate as

of what point in time "during the last month" the cost of fuel is to be computed.

3. The balancing account provisions are unclear since they refer to a rolling twelve-month average which requires additional clarification to determine the method of application.

4. Interest is excluded from the balancing account, despite the recognized regulatory lag inherent in the ECAC and appears inconsistent with the interest to be charged under this Decision on the Fuel Collection Balance.

6*(sic)*. The Decision seems to indicate that in the lifeline quantity area, it would be possible to make reductions to the billing factor, but that after these deductions were made, it would not be possible to increase the billing factor to the level that existed at December 31, 1975. Such an apparent ratcheting effect would seem to be unjustified and inequitable and unsupported by the record. The Commission's intent in this connection clearly requires clarification.

7. The decision is not clear as to whether or not the Commission intends to make a significant accounting distinction between the balancing account mentioned in Section C, on page 14 (which they specify is to be recorded "on the books of the utility"), and the "fuel collection balance" (representing any prior "overcollections") referred to in Section D, on page 15, which it indicates it will compute. The intention of the Commission in this regard should be clarified.

8. The exclusion of costs associated with fuel transportation facilities (including pipeline) from the operation of the new ECAC fails to specify that such costs are to be included

in base rate determinations which would be required to make the utility whole for such clearly proper costs of service.[14]

9. The Commission unclearly or inaccurately suggests in the Decision, at page 4, that the utilities had represented in their filings that no change would result in existing rate of return as a result of revenues generated under fca. The facts, as regards Edison are that it filed the periodic reports required by the Commission, showing, among other things, its rate of return on both an average-year and recorded basis. Such filings reflected different rates of return, none of which, on the basis on which the fuel clause was designed, exceeded the lower end of the range of rate of return adopted as reasonable in Decisions Nos. 78802 (72 Cal.P.U.C. 282) and 81919 (100 PUR (3d) 257).

H. *Specification Of Legal Error and Grounds For Rehearing*.

The thrust of the Commission's order and related findings and conclusions involved in Decision No. 85731 is that the respondent utilities should be required to submit additional data concerning fca revenue-expense differentials on a recorded basis for the period since the "birth" of the fuel clause in the case of each respondent and that that determination will be the basis for a refund requirement that will be implemented by a prospective adjustment in rates to offset over a three-year period such cumulative revenue-expense differential during the historical period since the fuel clause for each respondent has been in effect. Pursuant to Section

[14]In this connection, the Commission Staff took demonstrably inconsistent positions in this proceeding and in the proceedings involving Edison's general rate Application No. 54946, as shown in Edison's Opening Brief in that proceeding at page 18.

1732 of the California Public Utilities Code, Edison asserts as further grounds for rehearing of Decision No. 85731 the following:

1. Ordering Paragraphs 1a, 2b and 2c are based on Findings Nos. 1, 2, 3, 4, 10 and 12, and Conclusions Nos. 1(1) and 2(2). Such findings and conclusions are, in each instance, either not supported by the record or are contrary to law or both.

2. Conclusion No. 1(1) is based on Findings Nos. 1, 2, 3, 4, 10 and 12. Such findings are, in each instance, either not supported by the record or are contrary to law or both.

3. Conclusions Nos. 4 and 5 are based on Findings Nos. 1 and 4 which are not supported by the record and are contrary to law.

4. The method of calculation of the revenue-expense differential associated with the fuel clause revenues set forth in Conclusion 1(1) is erroneous aside from the improper use of recorded data for making such test calculation.

5. Ordering Paragraphs 1B, 2A and 3 are based on Findings Nos. 5, 6, 8 and 9. Edison believes that while some or portions of such findings may be supported by the record, the implied conclusion that the ECAC ordered by the Commission is an improvement over the existing average-year fuel clause is not and that, in fact, such ECAC has some major deficiencies, as discussed above, which should be further considered by the Commission.

I. *Miscellany*

1. Because of the adverse impact upon fuel oil prices and negotiations disclosed by the record and referred to in the Decision, we would urge the Commission to implement its observations on this issue by specifically reinstating the prac-

tice, formerly utilized by the Commission and sustained by the California Supreme Court, of permitting access to fuel oil contracts and prices, as well as written solicitations, bids and offers, only to its Staff which can fully verify the accuracy and truthfulness of the cost figures utilized in a utility's exhibits in formal proceedings, with, of course, full opportunity for cross-examination by interested parties as to the content of the exhibits presented in such proceedings, e.g., Commission Decision No. 55703 in Application No. 38382, 55 Cal.P.U.C. 743; Petition for Writ of Review denied by California Supreme Court June 2, 1958 (S.F. No. 19871).

2. Decision No. 85731 provides for no service upon the parties of the contemplated further Staff recommendations nor time for comments thereon, and thereby denies due process of law.

CONCLUSION

The Commission in this Decision has ordered Edison to file data purporting to indicate the amount of overcollection to be determined upon an improper test basis and analysis specified in the Decision, together with a sample Energy Cost Adjustment Clause conforming to the requirements and elements set forth in the Decision. In the Order, the Commission's Staff is directed, among other things, to recommend amounts of overcollection or undercollection and to recommend rate adjustments based upon its utilization of required data, analysis and determination, which the Order then specifies shall be utilized by the Commission for ordering proportionate rate adjustments upon the Edison system. No opportunity is provided in said Decision or Order for Edison to be heard or to provide comments with respect to such contemplated Staff recommendations and rate adjustments.

Under these circumstances and for each and all of the foregoing reasons, Edison believes the Commission's Decision to be defective; it is unsupported by the evidence; it applies unsound regulatory principles; it relies upon inadequate and inaccurate findings; the findings do not support the order; it is erroneous in law; the Commission's actions arbitrarily deny petitioner's legal rights and are violative of petitioner's rights under federal and state Constitutions in denying equal protection and taking property without due process (California Constitution Art. I, Sec. 13 and 23; U.S. Constitution Amendments Nos. V and XIV).

In light of the demonstrable illegality and impropriety of the Commission order, and in light of the failure of the majority of the Commission to focus upon the effect such an order will have on Edison's financial viability and its ability to continue to render adequate service to its customers in the future, the Commission should reconsider its order. The Commission should make express findings as to Edison's earnings for the period the fuel clause has been in effect under the test set forth by the Commission in its decision approving the clause, and as to the future effect of the order on Edison's ability to earn its authorized rate of return, and as to an appropriate method to be used to allocate any supposed "overcollections" between the fca and base rates, and as to the propriety of *including* in the supposed "overcollections" the fuel component contained in the base rates and of *excluding* the offsetting cost of purchased hydroelectric and nuclear power, franchise and uncollectible expenses, and other offsetting cost increases from Edison's recorded costs in the determination of the supposed "overcollections". The Commission should also correct the defects and clarify the ambiguities which are set forth in this Petition. Edison,

therefore, respectfully requests the Commission to consider the evidence, to make such findings based on the evidence, and, on the basis thereof, to modify its order accordingly.

In addition, because of the importance of the matter and the magnitude of the amounts involved and the irreparable damage which the Decision and the actions prescribed and contemplated by it would cause Edison, Edison also respectfully requests that the Order be stayed as to it, pending a final determination by the Commission and the Courts of the issues involved, so as to protect it from irreparable and unrecoverable damage should it ultimately prevail.

Respectfully submitted,

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(Verification and Certificate of Service omitted in printing.)

No.

APPENDIX G.

In the Supreme Court of the State of California

SOUTHERN CALIFORNIA EDISON COMPANY,
Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,
Respondents.

Petition for Writ of Review of Public Utilities Commission Decision No. 85731, With Points and Authorities in Support Thereof.

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TOPICAL INDEX

* Page references omitted in printing.

INDEX TO EXHIBITS

*Reproduced in this Appendix to Jurisdictional Statement at page 231.

**Reproduced in this Appendix to Jurisdictional Statement at page 41.

***Reproduced in this Appendix to Jurisdictional Statement at page 223.

TABLE OF AUTHORITIES CITED

* Page references omitted in printing.

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In the Supreme Court of the State of California

SOUTHERN CALIFORNIA EDISON COMPANY,

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vs.

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Respondents.

Petition for Writ of Review of Public Utilities Commission Decision No. 85731, With Points and Authorities in Support Thereof.

To the Honorable Donald R. Wright, Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Pursuant to Section 1756 of the Public Utilities Code, Southern California Edison Company ("Edison") hereby petitions this Court to inquire into and determine the lawfulness of Decision No. 85731, a three-to-two divided opinion rendered by the Public Utilities Commission on April 27, 1976. As recognized by the dissenting opinion, said Decision constitutes inequitable and unlawful retroactive ratemaking.

I. BACKGROUND OF PROCEEDINGS.

The decision of which petitioner seeks review resulted from the following proceedings:

1. On March 21, 1972, after full public hearings, the Commission issued Decision No. 79838 authorizing Edison to add a provision to its filed tariffs which would adjust customer rates for changes in the costs of fossil fuels (oil, coal and natural gas) used to generate electricity. (CPUC Appl. Nos. 52987 & 8, Dec. No. 79838, 73 Cal. P.U.C. 180 (1972).) A true and correct copy of Decision No. 79838 is appended hereto as Exhibit A. In general, the fuel cost adjustment ("fca") tariff provision, or "fuel clause," approved by Decision No. 79838, set forth the procedures by which the amount of each and every fuel cost adjustment was to be determined, including, in particular, the use of a 12-month forecast period and the assumption of average weather conditions as the basis for determining projected fossil fuel requirements during the forecast period. It permitted Edison to make quarterly "advice letter" filings seeking appropriate rate adjustments as changes occurred in the costs of fossil fuels from those reflected in Edison's then-existing base rates. Prior review by the staff and approval by the Commission were required before any such adjustment took effect. While the Commission did not contemplate holding public hearings with respect to each filing, it expressly retained the power to order such hearings as to any or all of them.

2. During the years 1972 through 1975, Edison made more than a dozen advice letter filings

pursuant to Decision No. 79838. In 1972 and 1973, the Commission approved the full amount of each of the fuel cost adjustments Edison requested. Thereafter, on September 25, 1973, the Commission, in Decision No. 81919, after full public hearings, approved a general increase in Edison's base rates which took into account the cumulative fuel cost adjustments theretofore authorized and reduced the fca component back to zero. Subsequent adjustments requested by Edison in 1974 were modified by the Commission before going into effect, and the Commission has not approved any of the fca filings made by Edison subsequent thereto.

3. On March 18, 1975, the Commission issued an Order Instituting Investigation ("OII") in Case No. 9886 for the purpose of reviewing the operation of the fuel cost adjustment tariff provisions to determine whether any changes should be made in them, including whether there were reasonable alternatives to the use of average-year conditions as a basis for determining the amount of the fuel cost adjustments and whether operating costs for nuclear, geothermal, and purchased hydroelectric power also should be taken into account in order to reflect changes in other energy costs incurred to generate electricity, rather than fossil fuel costs only.

4. After extensive public hearings were held in connection with the Commission's investigation, the Commission, by a three-to-two vote, issued Decision No. 85731 therein on April 27, 1976. A true and correct copy of Decision No. 85731

is appended hereto as Exhibit B. By that decision, review of which petitioner seeks herein, the Commission determined to replace the fuel clause described above with a new Energy Cost Adjustment Clause ("ECAC") permitting other energy cost changes, not just fossil fuel cost changes, to be reflected in charges for service under the new adjustment clause. The decision also switches the method by which rate adjustments under the ECAC are to be determined from the forecast average-year method formerly and historically used by the Commission in fixing rates, to a recorded-year method based on recorded energy use experienced in the most recent 12-month period and current energy prices. The decision also revises the administration of the filing procedure to provide for filings on a semiannual, rather than a quarterly, basis.

5. Petitioner does not claim that the Commission is without authority, upon substantial evidence, to adopt modified energy cost adjustment tariff provisions for the future. But the majority of the Commission did not so restrict itself. In Decision No. 85731 it further ordered that Edison go back to the inception of the fuel clause in 1972 and compute the difference between (1) the amount of revenue collected under the average-year based fuel clause approved by the Commission as just and reasonable in Decision No. 79838, and (2) the increased fuel cost actually recorded since then, a period involving abnormal weather conditions, so that a "rate adjustment" could be ordered by the Commission which would have

the effect of refunding this difference (alleged to be an "overcollection") to Edison's customers over a future period of up to 36 months. The Commission purported to find this amount to be $177.1 million as of August 31, 1975. (Decision, p. 38.)* This calculation assumes that an entirely different fuel clause had been in effect from the very beginning, despite the Commission's own admission that *all* fuel clause revenues were lawfully collected. (Decision, p. 41.) It is this retroactive feature of the Commission's decision which petitioner contends is prohibited by Section 728 of the Public Utilities Code and the decisions of this Court. The majority of the Commission expressly held to the contrary, asserting that a prospective rate adjustment and refund-credit based on "past performance" does not constitute retroactive ratemaking. (Decision, pp. 41-42; but *cf.* Dissenting Opinion, pp. 62-65.)

6. On May 6, 1976, petitioner made timely application for a rehearing before the Commission, which was denied on July 7, 1976, with two Commissioners dissenting. A true and correct copy of the order denying rehearing, together with the dissenting opinion, is appended hereto as Exhibit C. This petition is brought within 30 days of said denial, as required by Public Utilities Code Section 1756.

*Citations to portions of Decision Nos. 79838 and 85731 (attached hereto as Exhibits A and B, respectively) will be to the appropriate page in the appendix where the cited material appears. The decision under review (No. 85731) will be cited simply as "Decision", whereas the other will be referred to by number.

II.
SPECIFICATION OF ERRORS.

1. Petitioner alleges that respondent Commission acted without authority of law when it ordered an amortized reduction of petitioner's rates in order to refund to petitioner's customers certain revenues that petitioner collected for past service under rates which were lawful, final and formally approved by the Commission. That portion of the Commission's Decision No. 85731 which purports to make such an order conflicts directly with the express holdings of this Court that the Legislature has denied the Commission the power to engage in retroactive ratemaking. *Pacific Telephone & Telegraph Co. v. Public Utilities Commission,* 62 Cal.2d 634, 650 (1965); *City of Los Angeles v. Public Utilities Commission,* 7 Cal.3d 331, 356 (1972). This fundamental legal issue of the Commission's statutory authority should therefore be reviewed by this Honorable Court and resolved in conformity with this Court's prior rulings, as is set forth more fully in the memorandum of Points and Authorities which accompanies this petition.

2. Pursuant to the criteria specified in Decision No. 85731, petitioner, among other things, has been required to submit, and has submitted, data needed to calculate the amount of the amortized rate reduction ordered thereunder. Petitioner is informed and believes that respondent Commission intends to enforce Decision No. 85731 by further order unless review here is granted and this retroactive feature of the decision is annulled to arrest the unlawful actions of the Commission.

3. The Commission purported to find that, as of August 31, 1975, an "overcollection" of $177.1 million had occurred by testing the past performance of the fuel clause based upon recorded revenues and expenses, rather than average-year revenues and expenses as required by the clause. The Commission also ignored uncontradicted evidence that during the period in question, Edison's rate of return averaged significantly *less* than the minimum reasonable rate of return approved by the Commission, thus demonstrating that in fact no "overcollection" ever occurred. Finally, the Commission inaccurately applied its own recorded revenues-expenses test and ignored factors necessary for a proper evaluation of the fuel clause's past performance even on that basis, thereby resulting in a vast overstatement by the Commission of the supposed "financial inequities" it purports to remedy. Such actions by the Commission were arbitrary, capricious, unjust and not supported by substantial evidence and required findings.

4. Petitioner has no other plain, speedy or adequate remedy for the unlawful action of the Commission, except the granting of a writ of review by this Court. Petitioner respectfully represents that it is just, proper and necessary to protect its interests that a writ of review issue from this Court requiring respondent Commission to certify to this Court Decision No. 85731, together with the entire record in Case No. 9886; that this Court thereupon review Decision No. 85731 and vacate, annul and set aside the provisions thereof requiring the 36-month amortized rate reduction; and

that unless this Court so acts, petitioner will be unjustly and unlawfully deprived of its property without due process of law and will sustain great and irreparable damage.

WHEREFORE, petitioner prays:

1. That a writ of review issue out of this Court, addressed to respondent Commission, commanding and requiring it to certify to this Court, at a specified time and place, all of the records and proceedings in Case No. 9886; and that Decision No. 85731 be reviewed by this Court;

2. That this petition and all of said records and proceedings be fully inquired into and considered by this Court and that thereupon it be ordered that the 36-month amortized rate reduction required by Decision No. 85731 of respondent Commission be annulled, vacated and set aside;

3. That petitioner recover its costs of suit incurred herein; and

4. For such other, further and different relief as this Court may deem proper.

Respectfully submitted,

SOUTHERN CALIFORNIA EDISON COMPANY,
ROLLIN E. WOODBURY,
WILLIAM E. MARX,
and
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Attorneys for Petitioner.

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF PETITION FOR WRIT OF REVIEW.

I.
PRELIMINARY STATEMENT.

A writ of review is sought by Southern California Edison Company ("Edison") for that portion of Decision No. 85731, issued by the Public Utilities Commission of the State of California on April 27, 1976, with two Commissioners dissenting, which determined that Edison's rates should be reduced prospectively for a period of up to 36-months to effect a refund to Edison's ratepayers of an amount equal to the difference between (1) the revenues collected by Edison under its previously approved average-year fuel cost adjustment ("fca") tariff provision, or "fuel clause," since its inception in 1972; and (2) the increase in fossil fuel costs (over fuel costs reflected in base rates) actually recorded during that period. The existence of such a difference is primarily attributable to above-average precipitation and temperature conditions during the period in question. These abnormal weather conditions increased significantly the amounts of cheaper hydroelectric power and natural gas available to generate electricity and decreased the need for more expensive fuel oil. As a foreseeable and recognized consequence, the fca rate adjustments approved by the Commission during those years based on average-year conditions of precipitation and temperature produced more revenue in that short-term time frame than was necessary to offset the increase actually experienced in fossil fuel costs over base rate fuel costs. Had weather conditions been unfavorable, the opposite result would have occurred. (See Decision, p. 37.)

The Commission's order requiring Edison to refund to its customers this differential amount arises in the context of the Commission's full awareness that the use of the average-year forecast method predictably results in such short-term variations. (*Id.*) It also ignores the basic fact that during the period involved, Edison's overall rate of return was less than the *minimum* authorized by the Commission, despite the temporary advantage experienced in this single area of Edison's operations. Most importantly, the order amounts to a retroactive adjustment by the Commission of formally approved rates which long since have become final. Indeed, the Commission concedes, as it must, that Edison's rates were lawful, final rates and that all revenues Edison is being ordered to refund were collected lawfully. (Decision, p. 42.)

It is Edison's position that the Commission's contemplated retroactive rate adjustment, which seeks to revise Edison's fuel clause retroactively and to undo fca rate adjustments after the fact, is prohibited by the California law against retroactive ratemaking contained in Section 728 of the Public Utilities Code. Section 728 expressly limits the authority granted to the California Public Utilities Commission by the Legislature pursuant to Art. XII, Section 23 of the California Constitution, and has long been interpreted by this Court to forbid retroactive ratemaking such as is here attempted.

A. Background.

The background of this controversy is not disputed. In its Decision No. 78802, issued on June 15, 1971, the Commission found reasonable for Edison's operations a range in rate of return between 7.7% and 8.1%, and authorized Edison to increase its rates for

intrastate electric service so that it might realize a rate of return of 7.9% based on the test year 1972. (72 Cal. P.U.C. 282, 293-94 (1971).) The need for this rate increase was determined on the basis of projected revenues and expenses (including projected fuel expenses) for an "average year," *i.e.*, based on the assumption of historical average conditions of precipitation and temperature. This future average-year forecast method is the method pursuant to which rates have been set by the Commission for many years in California. Although it is, of course, impossible to forecast infallibly how actual weather conditions for each year will compare with the historical average, the Commission traditionally has made the valid statistical assumption that over a period of years variations from historical average weather conditions will balance out.

Because sharp increases were expected in the cost of fuel, in November 1971 Edison applied for, among other things, a rate adjustment and authority to amend its tariffs to include a fuel cost adjustment tariff provision, *i.e.*, a fuel clause, which would adjust customer charges at periodic times to reflect increases or decreases in the cost of fossil fuels. After public hearings, the Commission issued Decision No. 79838 on March 21, 1972, approving the fuel clause for the express purpose of allowing such future rate adjustments without having to engage in lengthy, comprehensive rate proceedings each time a significant change in fossil fuel costs occurred. (Decision No. 79838, pp. 17-18.) The Commission's decision provided for "advice letter" filings, which could not be made more often than once every three months and which were to be made not less than 30 days before the proposed effective date of a requested adjustment. Such rate adjustments

were to be made in conformity with the procedures specified in the fuel clause and were to become effective after being initiated by an advice letter, reviewed by the Commission staff, and approved by the Commission. (*Id.*, p. 14.) While public hearings were not required with respect to each filing, the Commission retained the power to order such hearings as to any or all of them as needed. (*Id.*) There was, of course, nothing new or unique about such a tariff provision or such regulatory procedures. Similar tariff provisions had been authorized for many years, both by respondent Commission and in other states, and were noted with approval by this Court in the recent decision of *City of Los Angeles v. Public Utilities Commission*, 15 Cal.3d 680, 695-703 (1975).

To determine the appropriate amount of revenue the fuel clause should generate under the procedure specified in the fca tariff provision, Edison was first to ascertain the total energy requirements anticipated during a 12-month forecast period beginning the day the requested adjustment was to take effect, based on the assumption that average-year weather conditions would prevail during that forecast period. The portion of these energy requirements expected to be met by non-fossil fuel sources was then to be deducted, with the remainder being an estimate of the forecast fossil fuel requirements. By estimating costs at the current prices for the projected requirements of natural gas, coal and oil, and deducting the costs of those fuels reflected in the base rates, the increase or decrease in revenue needed during the forecast period as a result of changes in fossil fuel costs would be fixed.

The projected fuel requirements, as noted above, were to be calculated on the same assumption of aver-

age-year conditions of precipitation and temperature as had been used by the Commission over the years in fixing utilities' base rates, including Edison's. (See *e.g.*, Johnson, Ex. 13, pp. 2-JEJ, 7-JEJ.) As to the proper manner of testing the performance of such a fuel clause, the Commission recognized that its own staff witness testified that an average-year test was appropriate to test the performance of an average-year fuel clause. (Decision, p. 38.)

It was, of course, predictable that during non-average years when the weather would be both wet and warm, relatively inexpensive hydroelectric power and natural gas would be available in more than average-year quantities for electric generation, and actual fossil fuel costs would be less than those projected on the basis of average-year weather conditions. Conversely, during non-average years when the weather would be both dry and cold, hydroelectric power and natural gas would be available in less than normal quantities and the actual fossil fuel costs would be greater than those projected on an average-year basis. Thus, although it was anticipated that revenue adjustments made under the fuel clause, over time, would average the actual variations in fossil fuel costs from those reflected in the base rates, the Commission knew when it decided to use the traditional average-year forecast method that during favorable years the fuel clause would yield revenues in excess of actual costs and during unfavorable years such revenues would fall short of actual costs. (See Decision, pp. 37-38.)

In approving Edison's fuel clause, the Commission expressly noted that "if a fuel cost offset proceeding is to achieve its primary purpose, which is to forestall a general rate case which would probably lead to even greater increases, the proper criterion for determin-

ing whether to grant or deny the increase is the effect on the previously found reasonable rate of return." (Decision No. 79838, pp. 7-8.) The Commission also required Edison to file annual reports with the Commission reflecting its experienced rates of return from which the Commission could monitor Edison's results of operations. The Commission further indicated, in rejecting the criticism that adoption of the fuel clause would decrease a utility's incentive to minimize costs, that "specific offsetting changes in other areas of Edison's operations will be considered by the staff in its evaluation of Edison's advice letter proposal to assure that Edison's proposed rates will not increase its earned rate of return above the lower limit of its previously approved range of rate of return." (*Id.*, p. 13.) Accordingly, the Commission in Decision No. 79838 made an express finding concerning the effect on Edison's rate of return of "the fuel cost adjustment authorized herein." (*Id.*, Finding 3 at p. 17.)

In full compliance with the requirements of Commission Decision No. 79838, Edison invoked the advice letter filing procedure on a quarterly basis during the years 1972 through 1975. On September 25, 1973, in Decision No. 81919, the Commission granted Edison an increase in base rates which took into account and "folded" cumulative fuel cost adjustments theretofore authorized into the newly adopted base rates. The Commission also adopted a new minimum reasonable rate of return of 8.2% for test year 1973 in fixing such rates for Edison's California jurisdictional operations. Thereafter, Edison continued to make quarterly advice letter filings as the costs of fossil fuel began to increase at an accelerating pace. The Commission granted the full amount of the final requested adjustment in 1973, reduced the amount of each request

in 1974, and has not acted on Edison's fuel cost adjustment filings subsequent thereto. With respect to each instance when the Commission approved an adjustment, either in the full amount requested or in a reduced amount, in making its determinations in the decision under review the Commission conceded that "all moneys collected by [Edison] in the rates authorized as a result of the fca tariffs *were lawfully collected after a finding by this Commission that the rates were just and reasonable*." (Emphasis added; Decision, p. 35.)

B. The Instant Proceedings.

On its own motion in March 1975, the Commission entered an Order Instituting Investigation ("OII") into the electric utility fca tariff provisions and procedures to determine what changes, if any, should be made. Hearings were held between May and October of that year, and briefs were submitted by all interested parties, including the Commission staff. On April 27, 1976, the Commission issued Decision No. 85731, which is the subject of this petition for review. In that decision, a majority of the Commission concluded that the performance of the existing fuel clause should be evaluated from its inception on an actual (recorded) basis, despite the fact that it was designed to operate on an average-year basis and despite the testimony by the Commission's own staff witness, who agreed with the utility witnesses, that the fuel clause should be evaluated on the basis of average-year conditions and not on the basis of abnormal short-term weather conditions. (Decision, pp. 37-38.) Characterizing that portion of the revenues generated by the fuel clause in excess of the subsequently determined increases in recorded fossil fuel cost above the base fuel cost as

"overcollections," the Commission majority concluded that this amount of revenue should be refunded to the ratepayers by reducing Edison's future rate levels for a period of up to 36 months. In effect, the Commission revised the fuel clause retroactively back to the time of its inception in 1972.

In entering its order requiring the 36-month amortized rate reduction, the Commission majority gave no consideration to, and made no finding of, the effect such a retroactive change would have on Edison's rate of return. It brushed aside without comment the uncontradicted evidence demonstrating that on an average-year basis, Edison's rate of return over the period 1972-1975 while the fuel clause was in effect averaged considerably *less than the minimum* of 8.2% adopted by the Commission in 1973 in Decision No. 81919, taking into account all revenues generated by the fuel clause, including those termed by the majority as "overcollections." (Exhibit 9B, p. 4-6.)[1] Instead, while purporting to recognize that Section 728 of the Public Utilities Code prohibits retroactive ratemaking, the majority

[1]Using the data from the annual results of operations reports the Commission had ordered Edison to file in connection with the fuel clause, the average rates of return during this period were 7.71% on a recorded basis and 6.73% on an average-year basis. Edison's annual rate of return on a recorded and average-year basis, as shown in these monitoring reports filed with the Commission, and minimum reasonable return, as found by the Commission in Decisions Nos. 78802 and 81919, were as follows:

Year	Recorded Rate of Return	Average-Year Rate of Return	Minimum Reasonable Rate of Return
1972	7.17%	7.20%	7.7%
1973	7.40%	7.27%	8.2%
1974	8.85%	6.90%	8.2%
1975	7.35%	5.69%	8.2%

(Petition for Rehearing, p. 29, fn. 1.)

drew a novel and unprecedented distinction between supposedly "specialized, extraordinary" fca rate adjustments and "general" rate adjustments—a distinction which, according to the majority, permits the Commission to require a reduction in future rates based on the "past performance" of the fca tariff provision measured on a recorded basis (Decision, pp. 42-43), even though all fca adjustments received formal Commission approval and all revenues collected thereafter admittedly were collected pursuant to the lawful, final rates thus approved by the Commission. (Decision, p. 35.)

Furthermore, the majority ignored the fact that there was no substantial evidence in the record to support a determination that *any* "overcollection" from customers had occurred. In making that determination, the majority, as noted, purported to test the fuel clause's past performance on a basis which even the Commission's own staff witness had disavowed. (Decision, p. 38.) While the Commission conceded that the existing fuel clause was a tariff designed to perform on an average-year basis, as is the case with Edison's other tariffs, was designed to match average-year revenues with average-year expenses, and had operated as so designed (Decision, pp. 34, 37), the Commission nevertheless opted for a test based upon recorded fuel expenses incurred in what the Commission recognized were non-average years. The improper test thus used by the Commission majority to measure "past performance" was contrary to the testimony presented by all witnesses. When past performance is properly tested, the record indicates a deficiency in revenues rather than an overcollection. (Exhibit 12, Table (a)2; Exhibit 38, Table 5; See also, p. 18, *supra.*)

In addition to ordering the amortized rate reduction described above, Decision No. 85731 provides for the

substitution of a new Energy Cost Adjustment Clause ("ECAC") for the existing fca tariff provision. The new energy clause is designed to operate prospectively using a recorded-year method, rather than the forecast average-year method. The decision provides for future rate adjustments pursuant to the ECAC not only for significant changes in fossil fuel costs, but also, "[t]o be fair and consistent" and "to reflect the true cost of energy sources on a system-wide basis," it includes adjustment for cost changes in *other* energy sources. (Decision, p. 49.) Thus, it includes changes in the cost of all energy sources used, including natural gas, coal, oil, nuclear power, geothermal power and purchased power, the sole exception being Edison's own hydroelectric generation (*Id.*), and makes allowance for the expense of franchise fees and uncollectibles attributable to ECAC revenues. However, when the Commission majority decided that "overcollections" for increased fossil fuel costs had occurred in the past on a recorded test basis and should be refunded, it did not see fit to view similarly the offsetting increases in recorded costs for these other energy sources during this time period or the offsetting effect of franchise fees and uncollectible expenses attributable to the fuel clause revenues. As indicated in Edison's petition for rehearing before the Commission, these two discrepancies alone are estimated to involve $50 million as of August 31, 1975. (Petition for Rehearing, pp. 23-24.) Furthermore, the Commission failed to allocate the revenue-expense differential between revenues attributable to the fuel clause and revenues attributable to the fuel cost component in Edison's base rates. This, as indicated in Edison's petition for rehearing, involves another discrepancy in excess of $70 million. (Petition for Rehearing p. 25.)

In the hearings before the Commission, Edison supported a prospective revision of its existing fuel clause to reflect future changes in the costs of these other energy sources, but questioned the wisdom of shifting from an average-year forecast basis to a recorded-year basis. Edison recognizes, however, that such prospective changes adopted by the Commission upon a proper record are within the Commission's authority. The latter aspect of the Decision is not challenged in the Petition to this Court.[2]

What *is* challenged is the determination by the Commission of an alleged fca "overcollection" and the amortization thereof by the future rate reduction it has ordered. Since the fca tariff provision was designed to operate on an average-year basis and each fca rate adjustment approved on that basis became lawfully and finally effective, there is no valid or substantive distinction between fca rates approved in the form of fuel cost adjustments and any other rate subject to the ban on retroactive ratemaking. Despite the Commission majority's erroneous attempt to characterize and to distinguish fuel cost adjustments as "specialized, extraordinary rates not created by or in a general rate proceeding" (Decision, Finding 1, p. 53), once a fuel cost adjustment becomes final, just like any other rate, it can be changed only prospectively under Public Utilities Code Section 728.

[2]It is appropriate to note, however, that the effect of switching from an average-year basis to a recorded basis is to shift the risk of non-average climatic conditions from Edison's shareholders to its ratepayers. The ratepayers will bear the burden of dry and cool years as well as enjoy the benefit of wet and warm ones. Consequently, under the Commission's new energy clause, volatile energy cost fluctuations are expected to result in widely varying charges to Edison's customers, whereas an average-year clause produces relatively constant customer charges in such a situation.

As will be shown, and as the two Commissioners who dissented from this aspect of the Commission's decision correctly pointed out, the statutory and case law prohibiting retroactive ratemaking by the Commission does not admit of such a distinction. Moreover, as further will be shown, there have been no "overcollections" under the fca tariff provision in either the legal or equitable sense of that term. In addition to the Commission majority's complete disregard of the prohibition against retroactive ratemaking, the Commission's equitable perspective is distorted by its failure to consider the effect of its rate reduction order on Edison's previously authorized reasonable rate of return and by its selective application of the recorded year test it used to determine the extent of the alleged "overcollections," so that fossil fuel costs only were considered. These and other defects in the Commission's decision were set forth in Edison's petition for rehearing filed on May 6, 1976, but the Commission denied the petition on July 7, 1976, two commissioners dissenting.

II.

THE COMMISSION'S DECISION TO ORDER A REDUCTION OF FUTURE RATES BASED ON REVENUES LAWFULLY COLLECTED FOR PAST SERVICE UNDER FINAL RATES APPROVED PURSUANT TO THE FUEL COST ADJUSTMENT TARIFF PROVISION CONSTITUTES RETROACTIVE RATEMAKING PROHIBITED BY SECTION 728 OF THE PUBLIC UTILITIES CODE.

A. The Pacific Telephone Decision.

It has been established at least since the landmark case of *Pacific Telephone & Telegraph Co. v. Public Utilities Commission*, 62 Cal.2d 634, 650 (1965), that the Legislature has not granted the Commission

"the power to roll back general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a commission decision ordering a general rate reduction." This conclusion was reached in a case, like the present one, where the Commission initiated an investigation of the utility's tariff provisions on its own motion. There, this Court annulled a Commission order directing Pacific Telephone to refund to its customers nearly $80 million which had been collected during the nearly two years while a rate investigation had been pending before the Commission. That sum had been collected in excess of the new rates adopted by the Commission at the end of its investigation, but pursuant to a prior rate which had become final. Even though the Commission found the prior rate to be *unreasonable* during that period, this Court held that the Commission nonetheless lacked authority to order a retroactive rate reduction. In the instant case, of course, the rate involved expressly had been found reasonable and all revenues collected thereunder were and have been found to have been lawfully collected. (Decision, p. 35.)

The teaching of the *Pacific Telephone* case is simply that once rates have been approved by the Commission in an order which has become final, the Commission thereafter may not deprive the public utility of amounts lawfully collected in accordance with those rates. But that is precisely what the Commission has attempted in Decision No. 85731. Edison's rates were adjusted on several occasions pursuant to the fca tariff provision the Commission approved in 1972. Each such adjustment received the Commission's formal approval, was expressly found to be just and reasonable, and long

since has become final. The rationale of the *Pacific Telephone* decision, the statutory and case authority it reviewed, the policies furthered by the ban on retroactive ratemaking, and subsequent developments in this Court and elsewhere, all make clear that there is no distinction between the retroactive rate adjustments ordered by Decision No. 85731 and any other attempt at retroactive ratemaking.

In concluding that the Commission lacks statutory authority to engage in retroactive ratemaking, this Court's opinion in *Pacific Telephone* began with the undisputed proposition that the fixing of rates is a legislative act, and then turned to the language of Section 728 of the Public Utilities Code, which provides in pertinent part as follows:

> "Whenever the Commission, after a hearing, finds that the rates . . . demanded, observed, charged, or collected by any public utility for or in connection with any service . . . are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable or sufficient rates . . . to be *thereafter* observed and in force." (Emphasis supplied.)

The Court agreed that this language was "plain and unambiguous" and expressed the intention of the Legislature that an order of the Commission fixing rates could apply only prospectively. 62 Cal.2d at 650.

That conclusion as to the "plain and unambiguous" meaning of Section 728 is equally as applicable to the present case as it was to the *Pacific Telephone* case. It is at once apparent that the term "rates" as used in Section 728 does not distinguish among

"types" of rates which the Commission lacks authority to adjust retroactively. No concept of "general rates" as opposed to "specialized, extraordinary rates" is contained in Section 728. Rather, the plain and unambiguous language of that section provides that any rate orders, like the rate order contained in Decision No. 85731, which are adopted by the Commission after a finding that the rates previously in effect are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential,[3] may take effect only prospectively.

The *Pacific Telephone* decision also makes clear that the Commission can take no comfort from any statutory powers granted to it in other sections of the Public Utilities Code. These were surveyed by the Court in *Pacific Telephone* and were found either to reinforce or be consistent with the conclusion drawn from the express language of Section 728. *Id.* at 650-654. Thus, the general grant of authority contained in Section 701 was found not to authorize the Commission to disregard the express directions of Section 728. *Id.* at 653. And the authority granted to the Commission in Section 729 to investigate a single rate or group of rates, and to establish new rates in lieu of the rates under investigation, was likewise found subject to the express direction of Section 728

[3]In fact, the Commission failed to make any such express finding in Decision No. 85731, and thus acted in violation of Section 728 even if the retroactive nature of its rate reduction order were not at issue. No implied finding that the prior rate adjustments approved pursuant to the fca tariff provision were unlawful, unjust or unreasonable may be imputed to the Commission either, despite its designation of the disputed sums as "overcollections," since it expressly assumed that the "rates authorized as a result of the fca tariffs were lawfully collected after a finding by this Commission that the rates were just and reasonable." (Decision, pp. 35, 42.)

that a new order fixing rates should apply only prospectively. *Id.* at 654. The Commission's statutory authority obviously must be at least as circumscribed when it exercises its powers with respect to final rates including an fca component as when it exercises its powers with respect to a single or group of rates under the express authority of Section 729.

Further relevant instruction can be gained from that portion of the *Pacific Telephone* opinion in which this Court reviewed the statutory provisions in the Public Utilities Code concerning the subject of refunds. The Court first noted that Section 1766 deals explicitly with refunds of amounts charged or received pending review and in excess of the charges allowed by the order of the Commission under review, where the Commission order lowering rates or denying the utility a rate increase has been stayed. The Court concluded from the fact that the Legislature had granted specific and narrowly delineated authority with respect to refunds in that particular context, that if the Legislature had intended to authorize the Commission to make the refund order at issue in the *Pacific Telephone* case, "it would have so declared in unmistakable terms." *Id.* at 654. Precisely the same can be said of the Commission's rate reduction order in the present case. Had the Legislature intended to authorize the action taken here by the Commission, it could and would have so declared.

Finally, the Court also pointed to Section 734, "which directs that when a rate has been formally found reasonable by the commission and charges collected accordingly, the commission shall not order the payment of reparation upon the ground of unreasonableness" and

found the principle of that section applicable to the unlawful refund order, despite the fact "that in reparation cases the complaint is often made by private parties rather than on motion of the commission" and the fact "that a reparation complaint is frequently addressed to the period before it is filed." *Id.* at 654-655. This principle is, of course, of particular pertinence to the rate adjustment order sought to be reviewed herein because here, too, the rates which the Commission now seeks to revise with the aid of hindsight were "formally found reasonable by the commission and charges [were] collected accordingly." (*Id.*) Indeed, there can be no doubt that the Commission in effect is attempting to declare that final rates previously found to be just and reasonable were, in fact, unjust and unreasonable. It would be difficult to conceive of a more blatant case of the attempted exercise by the Commission of retroactive ratemaking power.

In short, the Court's analysis of the statutory scheme in the *Pacific Telephone* opinion not only fails to support the Commission's purported distinction between "general" rates and "specialized, extraordinary" rates, but the opinion conclusively refutes the notion that any such distinction may properly be drawn. So, too, does the Court's response to the policy arguments advanced by the Commission in the *Pacific Telephone* case, which the Commission apparently seeks to advance again here, as to why retroactive ratemaking should be allowed whenever, with the benefit of hindsight, rates are thought to have been unreasonable or to have caused unjust enrichment.[4] This Court responded

[4]No "unjust enrichment" is factually present here, of course, because over the time interval involved, petitioner's rate of return averaged less than its authorized minimum reasonable rate of return. See Note 1, *supra*, p. 18, and accompanying text.

in 1965 by declaring that "[s]uch arguments should be addressed to the Legislature, from whence the commission's authority derives, rather than to this court." *Id.* at 655. The Legislature, however, has not amended the Commission's statutory authority in this respect since the *Pacific Telephone* decision was rendered—a fact cited by this Court in 1972 when it reaffirmed both the rationale and the holding of the *Pacific Telephone* decision in *City of Los Angeles v. Public Utilities Commission*, 7 Cal.3d 331, 356-357 (1972). Accordingly, the Commission still lacks the power to order the rate reduction contemplated by Decision No. 85731, whatever its thoughts on the "past performance" of the fuel clause may be.

B. The 1972 City of Los Angeles Decision.

The 1972 *City of Los Angeles* decision has further relevance to the Commission's rate reduction order. There this Court held that a Commission order granting telephone rate increases was invalid because it was based, in part, on the Commission's approval of the telephone company's accounting treatment of depreciation for ratemaking purposes—a treatment the Commission thought it was bound to permit and which this Court, in *City and County of San Francisco v. Public Utilities Commission*, 6 Cal.3d 119 (1971), had disapproved. This Court previously had issued a partial stay order providing that all sums collected by the telephone utility pursuant to the rate increases authorized by the decision under review should be subject to refund in whole or in part if the Commission treatment of the utility's depreciation method were annulled or modified. The utility subsequently requested

that if the rate increases were annulled, the Court should remand the case to the Commission to set a new lawful rate and should limit refunds to the difference between the increased rates annulled by the Court and the new lawful rate to be set in those further proceedings, rather than direct a refund based on the entire increase which was in effect under the invalid order. This Court rejected the utility's request, however, reasoning that once the rate increases under review were annulled, "the only lawful rates are those which were in existence prior to the instant decision . . . [and] to permit the commission to fix new rates for the purpose of refunds . . . would involve retroactive rate making. . . ." 7 Cal.3d at 356. It thus is clear that an attempt by the Commission to fix new rates for the purpose of refunds, as it has in effect attempted to do in the present case, is prohibited by Section 728 and the 1972 *City of Los Angeles* decision.

The Commission's semantic claim that this explicit case authority does not proscribe prospective rate reductions which are felt to be appropriate "because of past performance" (Decision, p. 43) is obviously incorrect. The simple fact is that the past performance to which the Commission refers is the lawful collection of revenues for past service to Edison's customers under final rates approved by the Commission which included the fca rate component. Finding that rates in the future should be reduced because revenues were "too high" in the past is no different than ordering that differential refunded. The adjustment of future rates on the basis of "past performance" is the very essence of retroactive ratemaking.

As the Supreme Court of Mississippi declared in upholding an order of that state's Public Service

Commission denying a telephone company the right to amortize past losses out of future rates, "[i]t is generally held that neither losses sustained nor profits gained by a public utility in the past may be taken into account in fixing rates to be charged in the future." *Mississippi Public Service Commission v. Home Telephone Co.*, 110 S.2d 618, 623 (Miss. 1959). *Accord, Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23, 31-32 (1926). This same principle has been recognized in California in the past, as the dissenting Commissioners below correctly pointed out. (Decision, Concurring and Dissenting Opinion, pp. 64-65.) In *Pacific Telephone & Telegraph Co.*, 48 Cal. P.U.C. 823, 836 (1949), for example, the Commission stated very clearly that "[p]ast deficits may not be made up by excessive charges in the future nor may past profits be reduced by disallowance to future operating expense."

C. Policy Considerations.

There are sound reasons why the legislative ban on retroactive ratemaking has been so widely adopted. First, "no utility could attract capital for expansion or replacement of its property and facilities, or for any other purpose, if the Commission could at one time fix rates for that utility and then at some later time rescind those rates retroactively, fix lower rates retroactively and require the difference to be refunded to the ratepayers." *Indiana Telephone Corp. v. Public Service Commission*, 171 N.E.2d 111, 124 (Ind. App. 1960). Second, to forbid a utility from charging any rates other than those prescribed after hearing and then to say that those rates may be declared unjust and

unreasonable as applied to executed transactions would disrupt the commitments the utility may have made in the belief that the sums it has earned and collected belong to it. *Michigan Bell Telephone Co. v. Michigan Public Service Commission*, 24 N.W.2d 200, 206 (Mich. 1946). Both of these cases were cited with approval by this Court in its *Pacific Telephone* decision. 62 Cal.2d at 651.

As the dissenting Commissioners perceptively recognized below, the rate adjustment order contemplated by the Commission majority in this case is equally as disruptive as any other act of retroactive ratemaking:

> "[T]o permit adjustment by means of retroactive ratemaking wreaks havoc to the whole scheme of supervision of public utilities in California. No decision would ever be final, either for purposes of establishing definitely the current income of the utility or allowing prospective investors to reliably evaluate the underlying value of securities to be purchased. Nor could any firm opinion based on generally accepted accounting principles be given as to the utility's assets and income, when retroactive ratemaking is permitted. What judicial review of the commission final orders could be had, when such orders would be subject to reconsideration, manipulation or adjustment at some undetermined future date? The reasons for the prohibition of retroactive rate-making are clear. With the uncertainty retroactive ratemaking invariably introduces, the cure is infinitely worse than the problem sought to be solved." (Decision, Concurring and Dissenting Opinion, p. 63.)

D. The 1975 City of Los Angeles Decision.

In the face of the statutory and case law authority and the policy considerations arrayed against its rate adjustment order, the action of the Commission has no legal defense. The "distinction" the Commission majority perceives between a prospective rate adjustment based on "past performance" and a refund order designed to carry out a retroactive rate adjustment is a purported distinction without substance. The further claim by the majority that rates arising from the application of the fca tariff provision are not "general rates," but are "specialized, extraordinary rates" not subject to the ban on retroactive ratemaking, also is a purported distinction without substance. Indeed, this latter "distinction" is refuted by this Court's recent opinion in *City of Los Angeles v. Public Utilities Commission*, 15 Cal.3d 680 (1975).

In that case, the Court overturned the Commission's determination that it lacked legal authority under section 728 of the Public Utilities Code to approve tariffs which would adjust telephone rates annually pursuant to a formula to take account of changing federal tax expenses. In reaching that result, this Court expressly rejected the argument "that a 'rate' is a single set of unvarying fixed charges, and that a 'hearing' must occur before each variation in those charges." *Id.* at 695. The Court also clearly recognized that periodic adjustment clause provisions, similar to the fuel cost adjustment clause in the present case, are subject to Section 728. *Id.* at 696, n. 33. Thus, the legislative ban on retroactive ratemaking embodied in Section 728 applies with full force to rate adjustment clauses and to rates determined by the application of such clauses. The retroactive revision

of an adjustment clause clearly constitutes unlawful retroactive ratemaking.

Incredibly, the Commission majority cited the 1975 *City of Los Angeles* case as lending some support to its claim that "[w]hen we find overcollections we have the option of reducing rates or reducing the rate of return." (Decision, p. 43.) The dissenting Commissioners properly recognized, on the other hand, that this Court's recognition therein that adjustment clauses are within the ambit of Section 728 means that retroactive rate adjustments with respect to fuel clause revenues are precluded by the prohibition of retroactive ratemaking contained in Section 728.[5]

The only other authority cited by the Commission majority in connection with their novel interpretation of the 1975 *City of Los Angeles* case was *City and County of San Francisco v. Public Utilities Commission*, 6 Cal.3d 119 (1971), and that was cited only by analogy. (Decision, p. 43.) It, however, involved the annulment of a Commission decision which had not yet become final and which was being reviewed. That is altogether different from the Commission's attempt in this case to revise rates authorized and approved as just and reasonable pursuant to the previously adopted fca tariff provision which have long since become final and lawfully effective. It is *final rates* which the Commission's order in this case seeks

[5]The Commission majority failed to honor even its own artificial distinction, of course, when it extended the scope of its retroactive rate adjustment order back to the period prior to Decision No. 81919, which last set base rates in a "general rate" proceeding in 1973 and incorporated in those new base rates the accumulated fca rate adjustments previously approved. No explanation has been forthcoming as to why the majority thought it properly could require retroactive rate adjustments based on fca adjustments between 1972 and Decision No. 81919, even if the Commission's own reasoning is applied.

to disturb, not, as in the *City and County of San Francisco* case, rates which the Commission's decision there under review proposed to make effective for the future, but which had not yet become final.

E. Other Jurisdictions.

A final instructive source of authority in establishing the illegality of the Commission's rate adjustment order is that resulting from the experience of other jurisdictions in similar situations. In Massachusetts, the Supreme Judicial Court recently held that the statutory grant of authority to its Department of Public Utilities did not include the power to order rate rebates for past inadequate telephone service. *City of Newton v. Department of Public Utilities*, 328 N.E.2d 885, 892-93 (Mass. 1975). In rejecting the claim that a power to order rebates could be implied from a general grant of authority to the Department to regulate and supervise utility activities, the Massachusetts court reasoned, as this Court had in the *Pacific Telephone* decision, that when the Legislature desired to give the Department the power to order any form of rebates, it had expressed its intent by specific statutory enactment. In the absence of such an expression, the Court was unwilling to imply that the Department had such authority. Particularly worthy of note is the Court's comment that a 1974 statutory amendment was required to bestow on the Department the power to order rebates for excessive charges under a fuel adjustment clause. *Id.* at

892, n. 12.[6] Evidently, it was recognized in Massachusetts that the power to make rate adjustments like that sought to be made by the Commission in this case required action by or authority from the state legislature. The legislative scheme in California, of course, is comparable to that involved in the *City of Newton* case prior to the 1974 amendment to the statute.

A similar conclusion can be drawn from the case of *Georgia Public Service Commission v. Atlanta Gas Light Co.,* 55 S.E.2d 618, 627-34 (Ga. 1949), a case cited with approval by this Court in its 1965 *Pacific Telephone* decision. There, the Supreme Court of Georgia held that where there were two rates for gas customers—a higher one for uninterruptible service and a lower one for interruptible service—the doctrine against retroactive ratemaking prohibited the Commission from ordering a utility to refund monies collected under the higher rate where the purpose of the order was to revise retroactively the utility's previously approved tariffs. The Court so held despite a finding by the Commission that service subject to the higher rate in fact had proved to be interruptible service—a circumstance which would have led the Commission to make it subject to the lower rate had it been

[6]The amendment, which added §94G to Mass. Gen. Laws ch. 164 (Supp. 1976), provides in pertinent part that the Department shall require monthly reports of fuel cost, purchased power charges and income derived from fuel charges, and "shall order rebates to customers if the total fuel charges billed to customers exceeds the amount required by companies to pay increases in the cost of fuel and purchased power."

foreseen. This decision was rendered in the context of a Commission order, similar to the one of which review is sought here, which directed that prospective adjustments be made over a 12-month period "until the full adjustment amount is satisfied." *Id.* at 628. The Georgia Supreme Court concluded, however, that such an adjustment was a prohibited refund, even though in retrospect the service rendered was not as contemplated under the previously filed tariff provisions.

Since that form of prospective rate adjustment is barred, *a fortiori,* the Commission's attempted rate adjustment in this case is barred. For here the service rendered was the service contemplated, the possibility that short-term variations between fuel clause revenues and increased fossil fuel expenses would occur was entirely foreseeable, and all rates charged by Edison were in accordance with existing and final tariff provisions filed with and approved by the Commission.

III.

THE COMMISSION'S DETERMINATION THAT EDISON "OVERCOLLECTED" FROM ITS CUSTOMERS IS ERRONEOUS.

It is difficult to understand how the Commission majority could ignore the impressive and uniform legal authority contrary to its proposed rate reduction order. Apparently, the principles to be found in these authorities were swept aside because of their eagerness to do something about supposed "overcollections" from Edison's ratepayers.

Of course, the authorities discussed above make clear that retroactive rate adjustments are impermissible even in instances where the prior final rates have been determined to be unreasonable or unjust. In this case, however, the Commission also errs in characterizing the amounts collected by Edison under its fuel clause in excess of actual increased fossil fuel costs as "overcollections." "Overcollections" or "overcharges" only exist when more than a filed tariff rate is charged, not when subsequent events indicate that the filed rate resulted in revenues different than anticipated. *Spintman v. Chesapeake & Potomac Telephone Co.*, 255 A. 2d 304, 307-09 (Md. 1969). But here the Commission concedes that "all moneys collected by [Edison] and the rates authorized as a result of the fca tariffs were lawfully collected after a finding by this Commission that the rates were just and reasonable." (Decision, p. 35.) No portion of Edison's charges under its filed tariffs, including charges under its fca tariff provision, therefore can be designated properly as overcollections.

This is made even clearer by the case of *Michigan Bell Telephone Co. v. Michigan Public Service Commission, supra,* a case which this Court cited with approval in its *Pacific Telephone* decision in support of its determination that the Commission has neither express nor implied statutory power to engage in retroactive ratemaking. 62 Cal.2d at 651-52. The Michigan Supreme Court rejected the claim made in that case that Michigan's Public Service Commission had power to order refund of such "overcharges," using language of particular pertinence to the present case:

> "The conclusion is not applicable to the instant case because in a correct sense 'overcharges' are not here involved. Instead the telephone company's charges were in accord with the existing lawfully established rates for the services rendered." 24 N.W.2d at 205.

That is precisely the situation addressed by the Commission in Decision No. 85731. No overcollections in a legal sense are involved because the Commission itself conceded that all of Edison's charges were in accord with existing, lawfully established, final rates which had been found to be just and reasonable when approved by the Commission. Indeed, this concession also means that the Commission not only failed to make the findings it is required to make under Section 728 to justify a rate change (see Note 3, *supra*, p. 25), it made contrary findings.

Nor does the Commission's mistaken characterization of the difference between the fca revenues Edison collected and the increase in fossil fuel costs over base rate fuel costs as a "windfall" to the utility (Decision, p. 41) add any equitable substance to the Commission's order. In actual fact, abnormal wet and warm weather conditions during the period in question created this temporary differential, and it is only the Commission's own decision to shift from an average-year forecast method to a recorded method that will prevent the averaging out of the effect of weather conditions on the revenue-expense differential in the long run.

Furthermore, during the relevant period, Edison's overall rate of return—the fact in which investors

in the financial community are primarily interested —averaged significantly less than the *minimum* reasonable rate of return of 8.2% authorized by the Commission in its Decision No. 81919 in September 1973, even when the after-tax effect of the revenue the Commission now seeks to describe as a "windfall" is taken into account.[7] It is unrealistic for the majority of the Commission in determining a supposed windfall to focus exclusively on the revenues collected by Edison to offset one component of its operating expenses and to ignore Edison's overall revenue deficiencies resulting from inflation in other costs and "regulatory lag." Those deficiencies, as the dissenting Commissioners below recognized, "have been enormous." (Decision, Concurring and Dissenting Opinion, pp. 66-67.) Not only is the Commission majority's tunnel vision unrealistic, but it expressly conflicts with the Commission's previously-held view of the operation of the fuel clause that "the proper criterion for determining whether to grant or deny [an] increase is the effect on the previously-found reasonable rate of return." (Decision No. 79838, p. 8.) Although the Commission does not suggest that it is departing from this fundamental principle, its failure even to consider the effect of its rate adjustment order on Edison's previously-found reasonable rate of return, and its characterization of the revenues sought to be refunded as "overcollections" and "windfalls," demonstrates its refusal to view the equities in the

[7]See Note 1, *supra*, p. 18, and accompanying text.

perspective it previously had said was proper. That refusal to do so clearly was arbitrary, capricious and unjust.

Finally, although the Commission did seem to recognize in the ECAC it prescribed for the future the equitable need to permit *all* energy costs to be passed through in the future on a recorded basis, in determining that there had been "overcollections" under the existing clause it conveniently ignored offsetting "undercollections," to use the Commission's terminology, which were experienced with respect to increased costs for purchased power during the period in question. Indeed, in large part it is the replacement of high-cost fuel oil by low-cost purchased power, available primarily because of favorable weather conditions, that reduced Edison's recorded fossil fuel expenses and thereby gave rise to the revenue-expense differential which has been treated by the Commission as an "overcollection." Yet the Commission refused, without explanation, to take increased purchased power expenses into account in its calculation of the "financial inequities" it perceived and purported to correct. In addition, the Commission failed to allow for the offsetting effect of franchise fees and uncollectible expenses attributable to fuel clause revenues, and failed to allocate the revenue-expense differential between revenues attributable to the fuel clause and those attributable to the fuel cost component in Edison's base rates. As pointed out in Edison's petition for rehearing, these discrepancies, taken together, account for most of the $177.1 million

"overcollection" that the Commission majority asserted has occurred. (Petition for Rehearing, pp. 23-25.)

IV.
CONCLUSION.

In sum, there is no legal or equitable basis for the Commission's retroactive amortized rate reduction order. This Court should not permit the Commission to violate the statutory limitations which the Legislature explicitly has imposed upon it and, by the use of such transparent reasoning, to evade the clear holdings of this Court that Section 728 of the Public Utilities Code forbids retroactive ratemaking.

For the foregoing reasons, Edison respectfully requests that this Court issue a writ of review and annul that portion of Decision No. 85731 which purports to order a rate adjustment to refund revenues lawfully collected by Edison.

Respectfully submitted,

SOUTHERN CALIFORNIA EDISON COMPANY,
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(Verification and Certificate of Service omitted in printing.)

APPENDIX H.

Answer of Respondent to Petition for Writ of Review.

SOUTHERN CALIFORNIA EDISON COMPANY,

Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,

Respondents.

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August 25, 1976

SUBJECT INDEX

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** Certificate of Service omitted in printing.

TABLE OF AUTHORITIES

*Page

* Page references omitted in printing.

To the Honorable Donald R. Wright, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the State of California:

Respondent, Public Utilities Commission (Commission), respectfully submits its answer to the petition of Southern California Edison Company (Petitioner) for writ of review and denies that petitioner is entitled to have said writ issued.

Statement of Facts.

By Decision No. 79838 issued March 21, 1972, petitioner was authorized to file a fuel cost adjustment tariff provision (fca) by which the utility was provided with a means to expediously offset changes in its operating expenses caused by increases or decreases in the costs of fossil fuel; i.e. coal, oil and gas, and by changes in the mixture of different priced fuels (*Application of Southern California Edison Company* (1972) 73 CPUC 180; see Pet., Exhibit A). Petitioner continuously points out and the Commission herein acknowledges at the outset that the fca predicates rate relief on an average-year basis whereby normal conditions of temperature and precipitation are assumed in projecting forecasts.

Between 1972 and 1975 filings were periodically made and substantial relief granted under this fuel clause. Similar type tariff provisions were subsequently authorized for Pacific Gas and Electric Company (*Application of Pacific Gas and Electric Company* (1973) 74 CPUC 781) and San Diego Gas & Electric Company (*Application of San Diego Gas & Electric Company* (1973) 75 CPUC 267).[1]

[1] Sierra Pacific Power Company was authorized to include a fca in its tariffs by Decision No. 81355 (*Application of Sierra Pacific Power Company* (1973) 75 CPUC 202, unreported). Sierra's fca was premised on a recorded basis instead of the average year concept.

On March 18, 1975, the Commission issued an Order Instituting Investigation (OII) into the various electric utilities fcas. Underlying the investigation was recognition that:

> "Based upon information available to the Commission, it appears that certain electrical corporations have been able to acquire significant revenues over fuel cost expenses actually incurred." (OII in Case No. 9886, mimeo at 2.)

By the investigation, the Commission specifically contemplated consideration of changes in the methodology for determining fca revisions and changes in the fca procedures.

Hearings were held on the OII. Thereafter, on April 27, 1976, the Commission issued the decision now under attack; Decision No. 85731. Among other things the Commission therein (1) decided to change from the existing fca provisions, predicated on an historic average-year basis, to an Energy Cost Adjustment Clause (ECAC), predicated on a recorded basis; (2) allowed for the recovery of several additional expenses under the ECAC which expenses were not considered under the fca; and (3) ruled that any "overcollections" realized under the fca should be handled through the adoption of a conversion adjustment and amortized over three years.[2]

On May 6, 1976, rehearing of Decision No. 85731 was sought by the instant petitioner. A second petition for rehearing was filed May 7, 1976 by Toward Utility Rate Normalization.[3] After evaluating these filings, the Commission issued Decision No. 86085 on July 7, 1976, therein denying rehear-

[2] "Overcollections" means simply fca revenues in excess of actual fca fossil fuel expenses. This concept is discussed further hereinafter.

[3] Toward Utility Rate Normalization has not sought further review of Decision No. 85731.

ing and modifying Decision No. 85731 in certain respects that are not pertinent in the evaluation of the present controversy. (See Pet., Exhibit C.) The subject petition to this Honorable Court followed.

Preliminary Statement.

Petitioner objects to two aspects of Decision No. 85731. Thus, exception is taken to the Commission's determination to view revenues collected under the fcas in excess of the underlying fossil fuel cost increases actually incurred as "overcollections" (Pet., 36-41). Petitioner also strenuously attacks the Commission's solution to the "overcollection" problem (Pet., 22-36). This answer will fully respond to both of these matters. However, before evaluation can be made of petitioner's contentions, a brief discussion of the fca is felt to be necessary.

It has been indicated hereinabove that petitioner's fca was established, as it was proposed, on an historic average-year basis. In other words, fossil fuel cost increases were estimated on a basis which considered that the forecast period would be a period of average precipitation and temperature.

This is important because, during above-normal wet and warm periods, lesser amounts of fuel oil, the highest priced fuel, are necessary to satisfy the utility's requirements. This result occurs due to the greater availability of the relatively cheaper hydroelectric power and natural gas. Conversely, if the time frame within which the rates are to apply is a drier and cooler period than normal, less hydroelectric power and natural gas will be available with the consequent necessity to burn more of the higher priced fuel oil than would be the case in an average period. With rates established on an average-year basis, it is easy to see how the utility might "overcol-

lect" or "undercollect" revenues which were designed to cover average-year fossil fuel expenses.

Of course, most, of not all, periods will deviate from the average to some degree. Thus, it is not to be reasonably expected that recorded results will track average-year forecasts in any particular period. However, it is reasonable to assume that over a period of time the highs and lows will "average" out. Indeed, this is the essence of any justification for the use of average-year forecasting in ratemaking.

Average-year forecasting is deeply ingrained in utility rate regulation in California. It underlies the great majority of general rate proceedings before the Commission.

However, there is nothing sacrosanct about average-year forecasting. Thus, while it has the positive regulatory effect of stabilizing rates, it also has the negative effect of rewarding or penalizing the utility for deviations from the norm until such time as the forecast periods average out. The magnitude of the reward or penalty is limited only by the degree in which actual weather conditions deviate from the average. As will be seen, the swing towards "reward" in the case at hand was approaching two hundred million dollars, representing an accumulation gathered over a period of about three years. It is this circumstance that was of primary concern to the Commission in the issuance of Decision No. 85731.

ARGUMENT.

I.

The Commission Did Not Err in Determining That Petitioner Had "Overcollected".

In Decision No. 85731, the Commission determined that petitioner had, under the average-year forecast fuel clause, been able to amass revenues on a recorded bases greatly in excess of the fossil fuel cost increases actually incurred under the fca. As of August 31, 1975, these excess revenues totaled $177.1 million.

Petitioner does not seem to disagree with the factual circumstance stated above (Pet., 11). Instead, petitioner objects to the characterization of this factual circumstance as "overcollections" (Pet., 37-38). Petitioner further challenges the use of this factual circumstance and argues that a proper evaluation of the fca should (1) not be based on recorded results at all; or (2) include consideration of the utility's rate of return; or (3) include consideration of other, non-fossil fuel, expenses.

Petitioner argues that the Commission's use of the term "overcollections" was erroneous. Thus it is asserted that revenues lawfully collected pursuant to just and reasonable rates can not be "overcollections" (Pet., 37).[4]

A detour into an analysis of a strict construction of the term "overcollection" obfiscates the real issue involved herein. Nothing is solved by a finding for or against the Commission in its characterization of the factual circumstances upon which the subject action is predicated. Thus, since the Commission does not herein rely on the term "overcollections", but, rather, relies on the accumulation of substantial dollars by petitioner without actual offsetting costs, any term can be substituted for the term "overcollections". After all is said, "a rose by any other name . . ."

[4]The Commission agrees that the subject revenues were so lawfully collected (Decision No. 85731 at 3; see Pet., Exhibit B at 35).

In issuing the underlying OII the Commission expressed concern with the accumulation of fca revenues in excess of fca recorded expenses. It decided to evaluate the average-year fuel clause. To this end the Commission reasoned that the performance of the fuel clause should be tested by actual recorded data. Petitioner disagrees. (Pet., 5, 7, 12, 15, 18, 19, 20, 21, 22, 36-41).

A. *The Average-Year Test*.

Under Petitioner's first line of attack, it is asserted the fca can only be properly tested on an average-year basis. Thus, petitioner would limit evaluation of the fca to the question of whether it had operated as it was designed to operate in a technical sense. The Commission will agree that such a limited test might be appropriate under other circumstances. However, as is plainly apparent from the OII, the concern of the Commission was not with the limited issue of whether the fca had operated as so designed but, rather, whether the design itself was reasonable. Thus, in embarking upon the consideration of changing the methodology employed under the fca, the appropriate evaluation must be broader than the very narrow test outlined by petitioner.

Petitioner has no legitimate claim in questioning the exercise of the Commission's investigative powers. In deciding to test the fca the Commission was exercising its discretion. This exercise should not be set aside unless it has been shown to be a clear abuse of discretion. That is not the case here.

As set out in the decision authorizing the fca, the purpose for that special extraordinary proceeding was to provide an expedited method for the recovery of escalating fossil fuel costs (*Application of Southern California Edison Company, supra*, 73 CPUC 180 see Pet., Exhibit A at 11). It is true as stated hereinabove that the proposed and adopted fuel clause provided that forecasts thereunder were to be based on average conditions. However, there is no analysis in that decision of the potential for substantial injury which could occur from the use of "average conditions". Average year ratemaking is not discussed by the Commission in any way. It therefore becomes obvious that that matter was not foremost in the Commission's mind. Instead, as was clearly enunciated in that decision, the Commission was convinced to allow the recovery of fossil fuel costs:

". . . so that [the utility's] ability to function is not impaired." (73 CPUC at 190.)

If petitioner could not recover *actual* escalating fossil fuel costs expeditiously, its ability to function might be in jeopardy. On the other hand, it is extremely difficult to see how depriving petitioner of a right to recover *excess* revenues computed on an average-year basis would interfere with its ability to function in any way.

Thus the Commission respectfully submits that petitioner's initial criticism of the Commission's analysis of the fca is totally devoid of merit. The Commission did not abuse its discretion in measuring the performance of the fca on an actual, recorded, basis. Instead, it used the only appropriate test to measure the performance of the fca against the goal sought to be achieved as outlined in the decision that authorized petitioner's fca.

B. *Rate of Return.*

In arguing against the Commission's test of the fca, petitioner next asserts that during the period involved its rate of return was less than the minimum authorized by the Commission. It is petitioner's position that the Commission improperly ignored this circumstance in Decision No. 85731 when "overcollections" were discussed (Pet., 7, 12, 15-16, 18, 22, 38-39).

Petitioner's attempt to insert the issue of rate of return in this proceeding is totally unreasonable. The relevant questions to be asked in measuring the performance of the fca properly must relate to the anticipated end sought to be reached by this special procedure. As seen, the goal sought by the establishment of the fca was the expedited recovery of increased fossil fuel costs.

Petitioner quotes out of context Commission language which expresses concern for rate of return (Pet., 15-16, 39). Thus it is argued that in approving the fca the Commission recognized that:

". . . the proper criterion for determining whether to grant or deny the increase is the effect on the previously found reasonable rate of return." (*Application of Southern California Edison Company, supra*, 73 CPUC at 184.)

The entire paragraph in which this quote is contained reads as follows:

"The California Manufacturers Association (CMA) takes the position that to the extent that any increase in rates is permitted to offset the increased cost of fuel, such increase should be reduced by the amount of the income tax reduction of $6.8 million as shown in column 5 of the results of operation study. The CMA's position shows the shortcom-

ings of an offset proceeding such as this one. It points out that only one element of cost is being considered among numerous cost factors which have changed since the last rate proceeding. However, if a fuel cost offset proceeding is to achieve its primary purpose, which is to forestall a general rate case which would probably lead to even greater increases, the proper criterion for determining whether to grant to deny the increase is the effect on the previously found reasonable rate of return. Within this concept, the fact of reduced tax expense is considered to determine if the fuel cost increase will cause Edison to earn more than the lower range of rate of return previously authorized by this Commission; it is not considered as a means of reducing the fuel cost increase. The evidence persuades us that the fuel cost increase requested by Edison will not increase Edison's rate of return to 7.7 percent, but will only increase Edison's rate of return to 7.41 percent. We are persuaded that the staff estimate of fuel mix is more accurate than Edison's, and we will authorize a revenue increase of $14.3 million." (73 CPUC at 184.)

In context, it is seen that rate of return is a concern to the Commission in offset and fca proceedings but only to a limited degree. Thus, increases in the costs underlying offset or fca proceedings will be allowed only to the extent that the utility's rate of return will not thereby be increased above its authorized level. The converse of this situation is not dealt with. Thus, the Commission has never expressly decided that offset or fca proceedings can or should be used as a vehicle to recover costs not actually incurred so long as the authorized rate of return level is not reached. That is petitioner's argument here and that argument must be clearly rejected.

C. *Other Costs.*

Petitioner's final attack on the Commission's determination of "overcollections" centers around the specific costs that should be evaluated. Thus, while the Commission limited its consideration to fossil fuel expenses, petitioner wants this Honorable Court to require the Commission to consider other expenses including those resulting from other energy sources, franchise fees and uncollectible expenses. Furthermore, petitioner claims that certain revenues were not properly attributable to the fca (Pet., 20).[5]

The Commission used a simple test to measure the performance of the fca. Since the fca was designed to allow for the expedited recovery through increased rates for increases in fossil fuel costs the appropriate measure would seem, naturally enough, to involve the consideration of (1) the revenues received under these increased rates and (2) the increases in these fossil fuel costs. That is precisely what the Commission did.

The Commission urges that petitioner's plea to offset the accumulation of excess revenues with other unrelated expenses be rejected. Simply stated, these expenses do not underlie the fca.

The Commission acknowledges that these other expenses which petitioner seeks to have considered in evaluating "overcollections", are now considered under the new ECAC. However, this circumstance has absolutely no rele-

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[5]According to petitioner the failure to consider other energy sources, franchise fees and uncollectible expenses is estimated as a $50 million error. The alleged error in failing to allocate revenues between the fca and base rates is quantified at $70 million. Although not indicated in the instant filing petitioner did note in its petition for rehearing that "the aggregate of the measure of these errors [is not] the sum of the figures developed . . ." (Pet/Rehrg. at 25, f.n. 2.)

vancy in determining the appropriate test to measure the performance of the fca. Although used in a different context, there is language in the petition that is entirely appropriate in characterizing petitioner's "other expenses" position here. Thus:

> "This calculation assumes that an entirely different fuel clause had been in effect from the very beginning . . ." (Pet., 5.)

Petitioner's plea to allocate revenues between fca and base rates is equally unreasonable. The "overcollections" quantified in Decision No. 85731 were calculated on the fca factor. It might very well be that "overcollections" were experienced with respect to those rates designed to allow average year recovery of base fuel costs. However, such "overcollections" constitute no part of the $177.1 million figure mentioned in the subject decision. This latter figure relates only to fca revenues exceeding fca costs.

Petitioner's attacks on the Commission's determination of "overcollections" are without substance. The Commission was acting entirely within its power in investigating the performance of the fca. Petitioner does not agree with the test used by the Commission, but petitioner has failed totally to show that that test was improper in any legal sense.

II

The Commission's Adoption of a Conversion Adjustment Does Not Constitute Retroactive Ratemaking.

In adopting the new ECAC procedure for handling changes in fuel costs the Commission recognized that a conversion adjustment was necessary in order to prevent the utilities from experiencing windfalls (Decision No. 85731 at 9; see Pet., Exhibit B at 41). As a consequence the Commission decided that "over-and undercollections", realized through the fca procedures, should be amoritized over a period not exceeding thirty-six months (Decision No. 85731 at 21; see Pet., Exhibit B at 54).

Petitioner's principal attack on Decision No. 85731 consists of the allegation that the challenged action constitutes retroactive ratemaking (Pet., 22-36). Thus, petitioner vigorously objects to the Commission's determination to adopt a conversion adjustment to handle the "overcollection" matter.

It is the Commission's firm position that Decision No. 85731 does not constitute retroactive ratemaking. Thus, the Commission recognizes the proscriptions laid down in *Pacific Telephone and Telegraph Co. v. Public Utilities Commission* (1965) 62 Cal.2d 634 and *City of Los Angeles v. Public Utilities Commission* (1972) 7 Cal.3d 331 but denies that Decision No. 85731 violates these authorities.

The use of average-year conditions in the fca has been discussed hereinabove. The Commission has shown that the basic justification for the use of this regulatory device is the assumption that, over a period of time, deviations from the average will balance out.

Petitioner agrees with this analysis. Thus, it is clearly recognized in the petition that:

". . . the Commission traditionally has made the *valid statistical assumption* that over a period of years variations from the historical average weather conditions will balance out." (Pet., 13., emphasis added.)

In Decision No. 85731, the Commission found that the average-year type of fuel clause should be abandoned because it (1) does not, in the short-term, accurately match fuel cost revenues with associated fuel cost increases and (2) generates controversy and litigation (Decision No. 85731 at 21; see also Pet., Exhibit B at 54).[6] Consequently, it was decided to change to a new procedure based on actual energy costs. Petitioner does not argue that this change is improper or unlawful as it applies in the future (Pet., 4, 21).

Once the above premises are recognized and accepted, the Commission's action in adopting the conversion adjustment can be seen in proper perspective. Thus, when it was decided to change the methodology of computing relief under the electric utilities' fuel clauses, the Commission was also faced with the factual circumstance that abnormal wet and warm weather conditions had been responsible for most of the utilities, including petitioner, accumulating substantial "overcollections". Since the weather cycle had not balanced-out, the Commission had basically three options to

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[6]It should be noted here that the abandonment of average-year forecasts applies only to the fuel clause proceedings. The Commission has not repudiated the use of this regulatory tool in general rate proceedings. Instead, it has merely decided that the extraordinary and limited fuel cost offset proceedings should be more closely tied to recorded results.

choose from: (1) it could allow the average-year methodology to continue for some undefined time into the future until a balancing-out was achieved and thereby defer adopting the preferred recorded fuel clause; (2) it could adopt the preferred recorded procedure immediately and simply allow the utilities to reap the rewards of undeserved benefits or; (3) it could adopt the new preferred recorded procedure immediately and require certain adjustments in recognition of the fact that the weather cycle under which the fca had operated had not yet run full circle. The Commission chose the latter option.

If the Commission had elected to retain the average-year format, it would be expected that sooner or later, the weather cycle would enter upon a dry and cool period. Under those conditions petitioner would then receive revenues *less* than the corresponding, underlying fossil fuel cost increases actually incurred. Thus it is seen that balancing-out in the context of average-year ratemaking means that past "overcollections" are expected to be offset by future "undercollections".[7]

It is precisely this same result that is accomplished by Decision No. 85731. The only difference between the amortization of overcollections, as required in the subject decision, and the continuation of the average-year fca until the completion of the present weather cycle is the certainty of

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[7]Petitioner agrees. Thus:

". . . abnormal wet and warm weather conditions during the period in question created this temporary differential [between fca revenues and fca costs], and it is only the Commission's own decision to shift from the average-year forecast to a recorded method that will prevent the averaging out of the effect of weather conditions on the revenue-expense differential in the long run." (Pet., 38; see also Pet., 15.)

time within which the amortization will take place and the uncertainty with respect to the time frame necessary to complete the current weather cycle.

It is beyond question that maintaining the average-year format into the dry side of the current weather cycle would not be improper or unreasonable or otherwise unlawful. It especially would not be vulnerable to a claim that it constituted retroactive ratemaking. How, then, can the subject Commission action, which has the same effect, be said to be illegally drawn? The Commission does not believe that it can be so found. Decision No. 85731 merely gives proper recognition and effect to the acknowledged fact that the weather cycle, on which the prior fca operated, had not run its course.

In making its argument petitioner reviews the policy considerations behind the ban on retroactive ratemaking. (Pet., 30-32). Basically, petitioner attempts to point out the results of the uncertainty and instability that would be felt by regulated industries subject to retroactive ratemaking.

The Commission will not disagree with this analysis as a general proposition. However, the analysis has no bearing on the case at hand.

As shown above, it must be prudently expected by every reasonable person that continuation of the average-year fca would result in sufficient "undercollections" in the future to balance-out the present "overcollections". That being the case, it must necessarily follow that Decision No. 85731 gives rise to no uncertainty or instability. Instead, it makes more definite the uncertain time aspects of the current weather cycle. In point of fact it is the reliance on average-year ratemaking that gives rise to the mismatching of revenues and expenses on a dollar for dollar basis and which thereby creates the uncertainty of not knowing when the average will average out.

Pacific Telephone & Telegraph Co. v. Public Utilities Commission, supra, 62 Cal.2d 634 is a classic case of retroactive ratemaking. There the Commission attempted to require refunds on revenues collected pursuant to rates previously found reasonable and subsequently found to be unreasonable. The instant proceeding, on the other hand, involves the adjustment of future rates because of an incompleted weather cycle. There are no refunds involved and the Commission has not found the previously approved rates to be unreasonable. Indeed, the Commission explicitly accepted the assumption:

> "That all moneys collected by the respondent utilities in the rates authorized as a result of the fca tariffs were lawfully collected after a finding by this Commission that the rates were just and reasonable." (Decision No. 85731 at 3; see Pet., Exhibit B at 35.)

Decision No. 85731 does not directly disturb previously collected revenues. It merely carries forward that which had already been contemplated, anticipated and accepted as the essence of average-year ratemaking. Thus there are fundamental differences between the *Pacific Telephone* decision and the challenged Commission order.

The same distinctions are present in a comparison of *City of Los Angeles v. Public Utilities Commission, supra,* 7 Cal.3d 331 and Decision No. 85731. In *City of Los Angeles* this Court rejected an attempt by the involved utility to offset a refund obligation, caused by the annulment of a Commission decision, by new rates to be subsequently set by the Commission. There, as in *Pacific Telephone*, an attempt was

made which, if successful, would have had the practical impact of rendering nonfinal all rate matters thus creating the uncertainty and instability in utility regulation that the ban against retroactive ratemaking is said to prevent. As plainly shown above, such an impact does not result from Decision No. 85731.

Based on the above analysis petition's (sic) claims of retroactive ratemaking should be dismissed. The Commission properly gave credence to past events in establishing a procedure for future fuel cost proceedings *in this case* because those past events were only permitted to occur with the assumption that they would be offset or balanced in the future. Under these circumstances retroactive ratemaking should not be found to exist.

CONCLUSION

This answer has responded directly to petitioner's claims. As shown the Commission properly considered the factual circumstance that, under the fca, petitioner had acquired substantial revenues in excess of actual fca cost increases. A change in procedures was shown to be necessary.

Having recognized the necessity for a change in procedures, the Commission then took the only action it could reasonably take. It required the balancing of a full weather cycle, to prevent petitioner from receiving a windfall in the amount of $177.1 million.

The Commission therefore respectfully requests that the petition for writ of review be denied.

Respectfully submitted,

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August 25, 1976

S. F. NUMBER

23500

APPENDIX I.

In the Supreme Court of the State of California

SOUTHERN CALIFORNIA EDISON COMPANY,
Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,
Respondents.

REPLY BRIEF.

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Respondents.

REPLY BRIEF.

To the Honorable Donald R. Wright, Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Petitioner, Southern California Edison Company ("Edison"), submits its reply to the answer of respondent Public Utilities Commission and respectfully requests that a writ of review issue as prayed for in its petition.

I.
PRELIMINARY STATEMENT.

Edison seeks a writ of review to set aside an unlawful retroactive ratemaking order entered by the Public Utilities Commission in Decision No. 85731. A three-to-two majority of the Commission determined therein that Edison's rates should be reduced for a period of up to 36 months in order to refund the difference

between (1) the revenues collected under its average-year fuel clause since it went into effect in 1972; and (2) the increase in fossil fuel costs (over those reflected in Edison's base rates) actually recorded during that period.

In its opening brief, Edison demonstrated that this action by the Commission constitutes unlawful retroactive ratemaking because all of the revenues Edison is being ordered to refund were collected pursuant to lawful, final rates, which were approved formally by the Commission and determined to be just and reasonable. Section 728 of the Public Utilities Code expressly limits the ratemaking authority granted to the Commission and has long been interpreted by this Court to prohibit all such attempts to undo lawful, final rates, notwithstanding the semantic claim by the majority opinion that ordering a rate reduction "prospectively" based on "past performance" does not constitute retroactive ratemaking. Edison further demonstrated that the action taken by the Commission is inequitable because Edison's rate of return during the period in question averaged significantly less than the minimum reasonable rate of return approved by the Commission, even when all of the revenues Edison now is being ordered to refund are taken into account.

In its answering brief, the Commission concedes the essential facts which establish that its order constitutes unlawful retroactive ratemaking. Indeed, the Commission expressly acknowledges that all of the alleged "overcollections" are revenues lawfully collected under rates heretofore found by it to be just and reasonable. (Answer at 6, fn.4.) The Commission also appears to abandon the principal ground relied upon by the majority opinion in its attempt to distinguish its action

from unlawful retroactive ratemaking. (Decision No. 85731, Appendix to Petition at 54, 57.) Nowhere does the Commission assert, as the majority had held below, that ordering a future rate reduction based on "past performance" does not constitute retroactive ratemaking.

Notwithstanding such concessions, the Commission continues to maintain that its action does not constitute unlawful retroactive ratemaking. It argues that the rate reduction is lawful because it is merely a "conversion adjustment" made in order to prevent Edison from reaping "undeserved benefits" from the Commission's decision to substitute a recorded method of calculating rate adjustments for the average-year method. (Answer at 14, 16.)

Such an argument, of course, would justify virtually any exercise of retroactive ratemaking power, so long as the attempt to undo lawful, final rates were accompanied by such a change in the methodology by which those rates were to be determined in the future. Section 728 flatly prohibits that. It contains no exception for "conversion adjustments" and no such exception should be recognized. The power to undo lawful, final rates is a power which, without exception, has been expressly denied to the Commission by the Legislature.

In its specification of errors, Edison also alleged that unless the Commission's action were set aside, Edison would be deprived of its property without due process of law. (U.S. Const. amend. XIV; Cal. Const. Art. I, §7.)[1] Edison is confident that the law and this Court's prior interpretations of Section 728 are

[1]*Cf. Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926).

sufficiently clear that the constitutional issue will not have to be reached by this Court, and for that reason its principal argument is based upon Section 728.

This reply is submitted, therefore, to demonstrate that the Court should reject the Commission's latest exercise in semantics, and should require the Commission to observe the statutory limitations which the Legislature has placed upon the Commission's ratemaking powers.

II.

SECTION 728 OF THE PUBLIC UTILITIES CODE PROHIBITS THE ACTION HERE TAKEN BY THE COMMISSION.

A. The Commission's Argument.

The Commission cites no authority to show that its "conversion adjustment" falls outside the ambit of Section 728 or is covered by an exception thereto. It simply asserts that its action, viewed in "proper perspective," is reasonable and lawful.

The "perspective" in which the Commission seeks to have its actions viewed is as follows: by 1975, when the Commission began to investigate the performance of the fuel clause it had approved in 1972, above-average wet and warm weather conditions which had predominated during that period had resulted in a substantial alleged "overcollection." In order to achieve a better short-term match between fuel clause revenues and associated increased fuel costs, the Commission determined in the decision here complained of that the average-year method should be replaced by a recorded method to calculate the size of future rate adjustments under a new formula type clause.

Because the weather cycle under which the fuel clause had operated between 1972 and 1976 had not yet "run full circle," the Commission saw itself as having basically three options:

> "(1) it could allow the average-year methodology to continue for some undefined time into the future until a balancing-out was achieved and thereby defer adopting the preferred recorded fuel clause; (2) it could adopt the preferred recorded procedure immediately and simply allow the utilities to reap the rewards of undeserved benefits or; (3) it could adopt the new preferred recorded procedure immediately and require certain adjustments in recognition of the fact that the weather cycle under which the fca had operated had not yet run full circle." (Answer at 16.)

The Commission essentially argues that maintaining the average-year methodology into the "dry side" of the present weather cycle would be lawful and that the rate reduction it has ordered "has the same effect." (Answer at 17.) The Commission then asks how one action can be said to be illegal when the other is not. (*Id.*) The answer, of course, is that the Legislature has granted the Commission power to change rates prospectively but not to change rates retroactively.

B. Edison's Reply.

The Commission's order, in fact, constitutes retroactive ratemaking that is indistinguishable from the "classic cases" of retroactive ratemaking struck down by this Court in *Pacific Telephone*[2] and *City of Los*

[2] *Pacific Telephone & Telegraph Company v. Public Utilities Commission*, 62 Cal. 2d 634 (1965).

Angeles[3]—cases which the Commission concedes are binding but purports to distinguish.

The semantic use of the phrase "conversion adjustment" cannot disguise the fact that the amount of the alleged "overcollection" required to be amortized is the difference between the revenues produced by Edison's average-year fuel clause and the actual increase in fuel costs recorded during the relevant time period. Moreover, all fuel clause revenues were collected pursuant to a final tariff which contained no provision for future rate reductions based upon the performance of the fuel clause. Therefore, the device now utilized, of amortizing this difference in the form of a future rate reduction purportedly based on the "past performance" of the clause, is legally and functionally no different than retroactive reatemaking in the form of an illegal refund. Indeed, the fact that the Commission also has ordered Edison to pay interest on the alleged "overcollection"—effective from April 1, 1976 until the total amount is fully paid out—underscores the economic reality that the rate reduction is no mere "conversion adjustment." The effect of the interest requirement is, of course, to make the rate reduction fully equivalent to a cash refund made on April 1, 1976. The Commission's order thus is nothing more than an amortized refund based upon a retroactive rate change.

The Commission also is incorrect in asserting that its rate reduction will have "the same effect" as would the continuation of the present average-year clause. Unless the present "weather cycle" inevitably will come

[3]*City of Los Angeles v. Public Utilities Commission,* 6 Cal. 3d 119 (1971).

to an end within the next 36 months on the precise schedule proposed for amortizing the "conversion adjustment," the two cannot be equivalent. Even then the two would not be equivalent because of the interest factor. The Commission majority made no finding that the "conversion adjustment" is equivalent to the continuation of the present average-year clause, and there is no evidence in the record that would support such a finding.

Moreover, allowing the Commission to exercise the power asserted here would create substantial financial uncertainty and instability. The Commission's assertion to the contrary is disingenuous because it refers solely to the effect of uncertain weather conditions (Answer at 18-19), when the rule recognized by the cases it purports to distinguish seeks to prevent a completely different kind of uncertainty—the uncertainty that would result if lawful, final rates were not truly final. If "conversion adjustments" are outside the ambit of Section 728, nothing prevents the Commission from making a further change in methodology a year from now—or even a month from now—and ordering yet another such adjustment, designed to compensate for whatever deficiencies the Commission then perceives in the methodology it adopts today. A major reason why the Legislature denied the Commission the power to undo lawful, final rates retroactively was to make them final, without exception. An exception for "conversion adjustments" would defeat that aim, just as would an exception for any other variety of retroactive ratemaking.

Furthermore, the Commission's argument on appeal would apply equally as well to changes in Edison's

base rates, which are fixed in the same manner, using the average-year concept. (Answer at 15, fn. 6.) Yet even the majority opinion implicitly acknowledged that the Commission lacks the power to do what it has done here in such general rate proceedings. (Decision No. 85731, Appendix to Petition at 43-44.)

Finally, the dilemma the Commission now perceives and purports to solve is one for which the Commission itself is responsible, and results solely from its decision to change a policy decision made by the Commission in 1972. Had the Commission in 1972 wanted to ensure that an exact balance would be reached between fuel clause revenues and increased fuel costs, it could have written a condition designed to do that into Edison's fuel clause.[4] To achieve that aim, the Commission not only would have had to endure that Edison would not recover more than its increased fuel costs in the event that weather conditions were above-average, it also would have had to ensure that Edison would not recover less than those costs in the event that weather conditions were below-average. Such a policy, in effect, would have assigned the risk of variations from historical average weather conditions to Edison's ratepayers, and would have marked a departure from the Commission's traditional policy of assigning that risk to a utility's shareholders. The Com-

[4]The tariff approved by the Commission is Appendix B to Decision No. 79838 and appears at pages 21 through 27 of the Appendix to Edison's opening brief. Even a cursory examination shows that it contains no condition that revenues collected thereunder are subject to refund in the event they exceed increased fuel costs. Instead, the control device adopted by the Commission was the requirement that Edison file periodic reports reflecting the overall results of its operations, which included its earned rates of return. (Decision No. 79838, Appendix to Petition at 12-13, 18-19.)

mission, in 1972, did not adopt such a change in its traditional policy; it adopted, instead, the unconditional average-year tariff it now seeks to undo retroactively. Had the Commission adopted a conditional tariff, petitioner obviously would have acted differently in the interim in seeking timely increases in its base rates in view of the rates of return it was earning. (See Petition at 18, fn. 1.)

The Commission made its decision in 1972 with full knowledge, based upon years of experience with average-year clauses, that variations in weather conditions could have a substantial impact on fuel costs. There has been ample occasion over the years to observe how average-year clauses operate in both average and non-average years.[5]

What the Commission essentially seeks to do now is to change Edison's average-year fuel cost adjustment tariff retroactively and to proceed as though it had approved a conditional tariff in the first instance. With the benefit of hindsight, knowing that the past four years have been favorable ones, the Commission seeks to take from Edison the benefit of favorable years after Edison already has borne the risk that those years would be unfavorable ones.

In sum, the Commission's action is neither equitable nor lawful, and its latest semantic justification for its actions should be rejected. No exception for "conversion adjustments" is contained in Section 728

[5]For example, half a century ago a severe drought occurred which more than halved the amount of hydroelectric power normally available at that time, drastically increasing the company's usual operating costs. In denying rate relief, the Commission extolled the virtues of average-year ratemaking as a method of eliminating "objectionable fluctuations in rates." *Southern California Edison Co.*, 25 C.R.C. 475, 478 (1924).

and no such exception should be recognized by this Court.

III.

THE COMMISSION'S DETERMINATION THAT EDISON "OVERCOLLECTED" FROM ITS CUSTOMERS IS ERRONEOUS.

More than half of the Commission's brief consists of an elaborate, but abortive, attempt to defend its determination that Edison "overcollected" from its customers. While Section 728 of the Public Utilities Code is itself dispositive of this case, Edison submits the following comments in response to such arguments:

First, in its petition for rehearing Edison expressly asked the Commission to make findings concerning what effect the rate reduction would have on Edison's rate of return, and to state the reasons why the Commission did not take into account the rate of return Edison had earned between 1972 and 1976 in entering its order. (Petition for Rehearing at 3-4, 41.) The Commission majority, however, denied the petition without responding to either request. (Decision No. 86085, Appendix to Petition at 68-70.)

For the Commission to order a reduction in rates even prospectively, it normally would be obliged to consider the rate of return the utility has earned and will earn in the future. In those cases where it determines not to take rate of return into account, it must, upon timely request, make findings in support of that determination.[6] Yet no findings were made

[6]Findings of fact and conclusions of law on all material issues are expressly required by the 1961 amendment to Section 1705. (Stats. 1961, ch. 1118, §1, p. 2843.) This is a jurisdictional requirement for an effective decision of the Commission. *Northern Cal. Power Agency v. Public Utilities Com.*, 5 Cal.3d 370, 380-81 (1971).

and no reasons were stated by the Commission majority why Edison should be required to refund the alleged "overcollections" under the fuel clause and, at the same time, should bear with equanimity the enormous revenue deficiencies it incurred during those same years. Those revenue deficiencies are attributable, in part at least, to cost increases in areas related to the fuel clause but not covered by it (see Petition at 40), as well as to the phenomenon commonly described as "regulatory lag," which the dissenting Commissioners pointedly described as Commission-induced "regulatory stall." (Decision No. 85731, Concurring and Dissenting Opinion, Appendix to Petition at 67.)

Second, Edison made a similar request with respect to various expenses which Edison submitted ought to be taken into account in determining the amount of any alleged "overcollection," but which the Commission did not consider. (Petition for Rehearing at 6, 22-27, 41-42.) A number of those offsetting expenses are ones which are to be taken into account under the new ECAC adopted by the Commission. Again, though, no findings were made and no reasons were given in support of the Commission's determination not to take them into account here. This means, for example, that the Commission has made no allowance for revenues accrued but not collected ("uncollectibles"). Thus, revenues are being characterized as "overcollections" and included in the total to be refunded which, in fact, never were collected. The Commission has yet to explain why Edison should be required to "refund" to its customers monies they never paid to Edison in the first place. (See also, Petition at 20, for other examples.)

IV.
CONCLUSION.

Edison has demonstrated that there is no legal or equitable basis for the Commission's amortized rate reduction order. During the entire period here involved, Edison averaged less than its minimum authorized rate of return, even when the entire amount of the alleged "overcollection" or "windfall" is considered. Perhaps, then, the hyperbole of the Commission's argument can be ignored for what it is. What cannot be ignored is that the Commission's order directing the refund of those revenues violates the express statutory limitation imposed by the Legislature under Section 728 of the Public Utilities Code and consistently recognized by the decisions of this Court.

For the foregoing reasons, Edison respectfully requests that this Court issue a writ of review and annul that portion of Decision No. 85731 which orders an adjustment in Edison's rates to refund retroactively revenues lawfully collected by Edison.

Respectfully submitted,

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Respondents.

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Respondents.

PETITION FOR REHEARING.

To the Honorable Rose Elizabeth Bird, Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Pursuant to Rule 27 of the Rules of Practice and Procedure adopted by the Judicial Council and the Supreme Court of the State of California, Southern California Edison Company ("Edison") hereby petitions this Honorable Court for rehearing of the decision heretofore filed by this Court on March 23, 1978, in Docket SF 23500. Said Decision was rendered by the Honorable Stanley Mosk, Acting Chief Justice, and was concurred in by the Honorable Donald R. Wright, Norman Elkington and Richard M. Sims, Jr., sitting under assignment. The dissenting opinion of the Honorable William P. Clark, Jr. was concurred in by the Honorable Frank K. Richardson and by the

Honorable Allison M. Rouse sitting under assignment. Said Petition for Rehearing is based upon the grounds that the decision is premised on a substantial error of law, misconstrues prior decisions of this Court and does not address substantial points presented in the Petition for Hearing.

Preliminary Statement.

The decision of the majority holds for the first time, and in the face of prior decisions of this Court to the contrary, that revenues lawfully collected by a utility pursuant to rates approved by a final order of the Public Utilities Commission (the "Commission") may, years later, be ordered refunded by a retroactive order of the Commission. If this decision is left to stand it will, as the dissent points out, create "uncertainties which can only result in downgrading all California utility bonds, potentially costing our citizens billions of dollars." (Dissent, p. 2).

The majority opinion is based on the false premise that there are two kinds of rates in the lexicon of public utility law. The first kind is called a "general rate" (Opinion, p. 3), meaning presumably a fixed rate in dollars and cents per unit sold by the utility. The second kind is a rate determined by adjusting a general rate through the mechanism of a "narrowly restricted and semi-automatic . . . adjustment clause" (Opinion, p. 26). The general rate, the majority says, remains inviolate from retroactive change. The adjustment does not.

The majority justifies the distinction on the theory that the act of calculating such an adjustment from time to time and adding it to the rates to be charged is not "true ratemaking," and so any such adjustment

may be revised retroactively. The dissent points out, but the majority fails even to consider, that the Commission's order approving such an adjustment procedure in the first place is clearly true ratemaking. (Dissent, p. 19). Consequently, any order of the Commission requiring retroactive revision of an adjustment made pursuant to such original order is a retroactive change in that original order and as such "patently constitutes retroactive ratemaking." (Dissent, p. 1).

The majority's rationale, as applied to the facts of this case, means that there is no mechanism ever to ratify or confirm such adjustments so that they become immune from retroactive change. Thus with each passing year the amounts accrued by utilities under rates affected by adjustment clauses and hence subject to possible refund at some unforeseen time in the future will continue to grow.

In reaching this result the majority misinterprets this Court's decisions in *City of Los Angeles v. Public Utilities Commission,* 15 Cal. 3d 680 (1975), and *Pacific Telephone and Telegraph Company v. Public Utilities Commission,* 62 Cal. 2d 634 (1965). The majority appears to be driven by a misapprehension that Edison has received some windfall that must be disgorged. As Justice Clark points out in the dissent, the record is to the contrary. (Dissent, p. 2). Edison's earned rate of return over the period involved was less than the *minimum* rate of return authorized by the Commission. And, as we shall show, even if one focuses on the difference between revenues Edison derived from the rate components affected by the adjustment in question and the actual costs associated with those components, there is no proof of any "overcollection" or "windfall."

Finally, the majority fails to address at all substantial objections that the retroactive order, if carried out in its present form, would require a rebate of a part of the "general rate" that even the majority says is not subject to retroactive change, and does not take into account the added cost to Edison of substitute sources of power that made savings in fossil fuel costs possible. The amount of this rebate of general rates plus the substitute power costs total more than one half of the amount of the refund ordered.

Outline of Significant Facts.

Because a majority of the current members of this Honorable Court did not take part in the consideration of this case or in the decision that prompts this petition for rehearing, we set forth below, in as simple a form as possible, the facts relevant to this petition, so that it may be read as an integrated whole.

The majority (Opinion, p. 7) points out that "the basic principle (of ratemaking) is to establish a rate which will permit the utility to recover its costs and expenses plus a reasonable return on the value of property devoted to public use." The majority (Opinion, p. 4) also notes that "general ratemaking is legislative and looks to the future." Hence, in ratemaking, it is necessary to forecast a utility's costs and expenses, and in the case of an electric generating utility this includes the cost of fossil fuels to be used in the generating plants. In general terms, this is done by forecasting the mix and amount of fossil fuels that would be used over an assumed test period under average weather conditions, determining what that mix and quantity of fuels would cost on the basis of forecast fuel prices for the test period and spreading those costs

over the number of units (i.e., kilowatt-hours) expected to be sold during the test period. This ingredient in the electric rate is sometimes called the "fuel cost component." The fuel cost component of electric rates has traditionally been calculated in this manner, using forecasts based on average year requirements.

On March 21, 1972, after a noticed hearing that fully complied with Section 728 of the Public Utilities Code, the Commission adopted Decision No. 79838. That decision was made at a time when the price of fossil fuels, especially fuel oil, was escalating. It approved a tariff provision, called a fuel cost adjustment clause, under which Edison could, from time to time, obtain approval on an expedited basis to increase its rates as the price of fossil fuels increased. Approval of such an increase was to be sought by filing an "advice letter" with the Commission. That letter was to contain data which in essence would compute a new fossil fuel cost component for Edison's rates in the traditional manner using updated figures, and to show what increase in rates was needed to reflect this newly calculated fuel cost component. The increases would go into effect only after the Advice Letter had been reviewed, verified and recommended for approval by the staff and formally approved by the Commission, after public hearings if ordered by the Commission. Specifically Decision No. 79838 declares that:

> ". . . specific offsetting cost changes in other areas of Edison's operations will be considered by the staff in its evaluation of Edison's advice letter proposal to assure that Edison's proposed rates will not increase its earned rate of return above the lower limit of its previously approved range of rate of return."

Thus the Commission's control mechanism to prevent any excessive earnings was to be its review of the experienced rate of return compared with the rate of return last finally authorized by the Commission.

The amount of the increases just described is what has been called the fuel cost adjustment. The rate absent the adjustment will hereafter be called the base rate which, of course, contained a fuel cost component. In short, Edison's rates reflected fuel costs in two ways—in the fuel cost component of the base rate and also in the fuel cost adjustment.

In the years 1972 through 1975, the price of fossil fuels escalated and Edison made quarterly filings under the fuel cost adjustment procedure. The adjustments sought were routinely approved in 1972 and 1973. On September 25, 1973, by Decision No. 81919, the Commission approved a new base rate for Edison. The fuel cost component used in arriving at that base rate was increased to equal the fuel cost component of the previous base rate plus the fuel cost adjustment then in effect. This wiped out any need at that time for a fuel cost adjustment, because the entire fuel cost was included in the base rate. Later, as fuel prices continued to rise, further rate increases were sought pursuant to the fuel cost adjustment. During 1974 these requests were approved, some after downward modification by the Commission. In 1975 applications were also made but none were acted upon and so did not go into effect.

As it turned out, the amount of fuel oil that Edison burned in its generating plants during these years, and particularly during the calendar year 1974, was less than the "average year" usage that had been employed in computing the fuel cost component of the

base rates and the fuel cost adjustments. This was due primarily to the fact that these were warmer and wetter than average years, so that the amount of hydroelectric power that Edison generated in its own plants and purchased from others exceeded the amount it generated and purchased in an "average year." To a lesser extent the need for fuel oil was reduced by availability of larger than average quantities of natural gas, a cheaper fuel than fuel oil.

As a result of these circumstances, Edison's actual cost of fossil fuels was less than the revenues it derived from the fuel cost component of its base rate plus the fuel cost adjustment during the period from March 21, 1972 (the date of Decision No. 79838) to April 27, 1976 (the date of Decision No. 85731, of which more later).* The majority, viewing this difference in isolation, called it an "overcollection." For convenience we shall use that term, without conceding its accuracy, or use the term "fuel cost-revenue differential."

All parties agree that the rates charged by Edison during this period were in strict accordance with the applicable decisions of the Commission and were in all respects lawful and proper.

Furthermore, Edison incurred increases in other kinds of costs (materials, labor, environmental protection, taxes, depreciation, cost of debt, etc.) in the aggregate above the level of revenues it derived from components

*This is not to suggest that there was not a difference between actual fossil fuel costs and revenues derived from the fuel cost component of rates charged during earlier periods. As we explain below, such differences, sometimes in Edison's favor and sometimes to its disadvantage, were expected and occurred over the years.

of its rates that were intended to reflect such costs, thereby producing an "undercollection" or negative cost-revenue differential that more than offset the "overcollection" of fossil fuel costs. As a result Edison's rate of return on a recorded basis averaged less than the rate authorized by the Commission as the minimum reasonable rate of return.

This set the stage for Decision No. 85731, made on April 27, 1976, and the subject of these proceedings. By this decision, the Commission terminated the fuel cost adjustment and substituted in its place a procedure called the Energy Cost Adjustment Clause ("ECAC"). ECAC provides that rates to be charged in the future are to be periodically adjusted to reflect actual recorded costs for all forms of energy—fossil fuels, nuclear energy, hydroelectric power and purchased energy.

The ECAC in and of itself is not in issue here. However, in the same order the commission required Edison to refund .to its rate payers, by means of a rate reduction over the ensuing three years, the total fuel cost-revenue differential from March 21, 1972 to April 27, 1976. Such a refund will cost Edison at least $133 million (Opinion, p. 17, fn. 17). It will retroactively reduce Edison's rate of return during this period "closer to 4 percent than to 8" (Dissent, p. 2) at a time when the minimum reasonable rate of return approved by the Commission was 8.2%.

Decision No. 85731, if allowed to stand, is plainly and simply a retroactive modification of the order that approved the fuel cost adjustment procedure (Decision No. 79838 of March 21, 1972). The Commission has now declared, after the fact, that rather than pred-

icating its rates on forecasts based on average weather years, as is specifically required by the order of March 21, 1972, Edison's rates shall be retroactively changed to reflect Edison's actual costs for fossil fuels during a limited time period, revenues collected under such rates shall be correspondingly recomputed, and the difference shall be refunded.

ARGUMENT.

1. The Majority Fails to Recognize or Even Consider That the Order Here Under Review Retroactively Changes Decision No. 79838, a Final Order of the Commission Adopted After Notice and Hearing and as Such Admittedly Immune From Retroactive Change.

The majority recognizes that "retroactive ratemaking" may not be engaged in by the Commission, as this Court has held many times. *Pacific Telephone and Telegraph Company v. Public Utilities Commission,* 62 Cal.2d 634 (1965); *City of Los Angeles v. Public Utilities Commission,* 7 Cal. 3d 331 (1972); *City of Los Angeles v. Public Utilities Commission,* 15 Cal. 3d 680 (1975). (These cases are called, respectively, *Pacific Telephone, City of Los Angeles I* and *City of Los Angeles II* in the Opinion and will be likewise denominated here.) This result follows from Section 728 of the Public Utilities Code which provides in pertinent part as follows:

> "Whenever the Commission, after hearing finds that the rates . . . collected by any public utility for or in connection with any service . . . are insufficient, unlawful, unjust (or) unreasonable . . . the Commission shall determine and fix, by order, the just, reasonable, or sufficient rates . . . to be *thereafter* observed and enforced."*

The majority now declares that the rule against retroactive ratemaking protects only "general rates" (Opinion, pp. 2, 3), seizing on the unexplicated use of that term in two places in the *Pacific Telephone* opinion (62 Cal. 2d at 650 and 655). The majority

*Here and elsewhere emphasis is supplied unless otherwise noted.

reasons that by using this term this Court meant to exclude from the rule that rates may not be changed retroactively any rate that results from a semi-automatic adjustment prescribed by Commission order. It reaches this result by arguing that the act of effectuating a rate adjustment pursuant to a formula or truncated procedure prescribed by the Commission is not a "true ratemaking proceeding" under Section 728 (Opinion, p. 28), and since there is no "true ratemaking" the rule against retroactive "ratemaking" does not apply (Opinion, p. 5). The majority fails to go back to the source of those rate adjustments. In this case it is Decision No. 79838, adopted March 21, 1972— "a true ratemaking" order and the one which will be changed retroactively by the decision here under review if it is allowed to become effective.

This oversight led the majority inexorably to an erroneous result.*

The nature of a proceeding that orders the addition of an adjustment clause to a rate was considered in *City of Los Angeles II,* an aspect of the case the majority did not consider. In that case the Commission and the utilities argued that such a clause would violate Section 728, because adjustments to rates would be made in the future without a hearing. The court rejected that contention, reasoning that the adjustments would flow from the proceeding that adopts the adjustment

*Initially, for purposes of the argument, we assume here with the majority that the periodic adjustment procedures did not constitute "ratemaking." In fact, we believe the assumption to be incorrect. *City of Los Angeles II* described the annual adjustment there under consideration, a completely automatic procedure not having the staff and Commission review and approval that was required in the case of Edison's fuel cost adjustment, to "closely approximate annual ratemaking." (15 Cal. 3d at 693, Footnote 29)

clause, and that such a proceeding meets the requirements of Section 728.

The Court relied on *Norfolk v. Virginia Electric, etc. Co.,* 197 Va. 505 (90 SE 2d 140) (Va. 1975), in support of this conclusion. In that case an escalator clause in a utility rate was challenged on exactly the same ground under a statute similar to Section 728. In upholding the clause the court made the following statement, which is quoted with approval in *City of Los Angeles II* at page 697:

> "'[R]ate schedules consist not merely of lists of rates in dollars and cents, but . . . they customarily include provisions that will in various ways affect the rates charged at the time of filing or to be charged thereafter.' The proposed escalator clause is nothing more or less than a fixed rule under which future rates to be charged the public are determined. It is simply an addition of a mathematical formula to the filed schedule of the company . . . [I]t is clear that notice is not required on each occasion there is a change in the ratepayers' bills, but that *notice is required for every change in the filed schedules which are the underlying basis for the computation of those bills.*"

City of Los Angeles II then considered the constitutional requirements applicable to the adoption of an adjustment clause and concluded:

> "[*N*]*orfolk* thus stands for the proposition that due process requires adequate hearings at the significant point of the adoption of the adjustment clause, rather than at the relatively unimportant occasions of its application." (15 Cal. 3d at 700.)

So rates are rates, whether they consist of "lists of rates in dollars and cents" or contain an adjustment or escalator clause. The pages of *Pacific Telephone* may be searched in vain for any suggestion that the unexplicated use of the term "general" rates was intended to differentiate between these kinds of rates. To the contrary, the opinion repeatedly refers to rates in unqualified terms (e.g. 62 Cal. 2d at 650, 651, 652, 654), and in explaining the meaning of *Pacific Telephone* in *City of Los Angeles I,* this Court refers to "rates" and "charges":

> ". . . . the commission is given power to prescribe *rates* prospectively only, and . . . . the commission could not, even on grounds of unreasonableness, require refunds of *charges* fixed by formal finding which had become final." (7 Cal. 3d at 356.)

Finally, *City of Los Angeles II* refers to "the promulgation of an annual adjustment formula *as part of a general utility tariff* . . . ." (15 Cal. 3d at 699).

In conclusion, if, as the majority argues, the effectuation of the fuel cost adjustments from time to time was automatic and hence not "ratemaking", the act of authorizing that procedure in Decision No. 79838 certainly was "ratemaking." In fact, in making the orders that both adopted and applied the fuel cost adjustment, the Commission was exercising the discretion and making the choices which inhere in a ratemaking proceeding. In adopting the clause choices were made, including the choice to fix adjustments on an average rather than a recorded year basis. In applying the clause the Commission in essence reaffirmed this decision and at the same time exercised its retained discretion to review and reject the data submitted by

Edison in its advice filings and to approve or disapprove adjustments in the light of Edison's overall rate of return. The order here under review is a bold attempt by the Commission, years later, to reverse its decisions, revise its choices, and undo its findings. This is clearly retroactive ratemaking contrary to the law.

2. The Majority Misreads the Import of City of Los Angeles II as Permitting Retroactive Orders Requiring Refunds of "Past Overcollections."

In its effort to find support for its holding in *City of Los Angeles II,* the majority makes the following statement about that case (Opinion, p. 30):

> "We there proposed alternative methods by which the telephone utilities could be prevented from benefiting from the collection of rates which, although lawful, were higher than necessary because they had made provision for tax expenses that did not materialize. Among those alternatives, we advised the commission that it could compensate for such past overcollections by the device of reducing the utilities' rate of return in the future: 'the commission could choose to mitigate the "windfall" accruing to [the utilities] in consequence of their failure to elect accelerated depreciation prior to 1969, *by setting more modest rates of return* in recognition of the additional source of capital available to the utilities by virtue of the federal tax laws.' (Italics added) (15 Cal. 3d at pp. 704-705, fn. 42.)" (Footnote omitted)

The majority thus interprets *City of Los Angeles II* to mean that "past overcollections," that is to say

revenues lawfully collected under rates previously approved by final order of the Commission, can, after the fact, be ordered refunded through a reduction in future rates. And the majority's statement here is not even limited to "overcollections" pursuant to an adjustment clause. In fact there were no "past overcollections" in *City of Los Angeles II*. The rate orders that would have given the utilities the "windfall" alluded to were annulled, or expressly made conditional pending the outcome of the proceedings, *before they became final.* 15 Cal. 3d at 689, fns. 13 and 15. The reason these steps were taken is explained in *City of Los Angeles I*, 7 Cal. 3d at 338, and that explanation is quoted in *City of Los Angeles II* with the court adding the emphasis:

> "It follows that, unless the rate order now before us is annulled, it will *become a lawful rate* and that all funds collected pursuant to it would belong to Pacific and not be subject to refund. [¶] In other words, we must annul the rate order now before us, because otherwise the rates therein, which are based in part on the annulled tax expense decision, will *become lawful rates* for the future and will preclude refunds." (15 Cal. 3d at 706.)

So *City of Los Angeles II* is not a case of retroactively ordering refunds of previously collected revenues. As the dissent herein points out (Dissent, pp. 22-23), the change in rates the Court recommended to the Commission in that case was entirely prospective in character. Pacific Telephone and General Telephone had used straight line depreciation for many years, and their rates took that expense into account. The series of cases ending with *City of Los Angeles II* was

prompted when they switched to accelerated depreciation, which increased their depreciation expense for income tax purposes and thus reduced their tax. The Commission thereupon authorized them to use accelerated depreciation for ratemaking purposes and granted rate increases that reflected the increased depreciation expense, but not the resulting tax savings. The Commission and the utilities justified this on the theory that the tax laws required it. Before orders approving the rate increases became final, they were annulled as to Pacific Telephone and made conditional as to General Telephone as we have heretofore described. All that *City of Los Angeles II* held was that the Commission had the power to put into effect an annual adjustment formula that would indirectly pass on to the rate payers whatever financial benefit the utilities might derive from the use of the funds accruing to them *in the future* by reason of the tax saving. To correctly summarize this decision in the language used by the majority, one would say that the court proposed these methods so that "the telephone utilities could be prevented from benefiting from the *future* collection of rates which, although lawful, *would be* higher than necessary. . . ." Thus the Court said:

> "The adjustment clause would operate upon figures which the utilities had placed in their account books in accordance with the system of accounts as to which the companies had received another, prior hearing, (Pub. Util. Code, §§ 792, 794). (Footnote omitted) The utility, of course, would have made the entries with the full knowledge that the commission would employ them in connection with the annual adjustment clause. (Footnote omitted)" (15 Cal. 3d at 699.)

The language from *City of Los Angeles II* quoted by the majority, when divorced from the term "over collection" which the majority gratuitously engrafts onto it, is clearly forward-looking. The Court there did not instruct the Commission to *recover* a "windfall" which *had accrued* but to *"mitigate* the 'windfall' *accruing."* The alternative methods suggested by the Court were described as directed to the problem presented by "this *new source* of investment capital" (*City of Los Angeles II, supra,* 15 Cal.3d at 691) and by "the additional *source* of capital available" (*Id.* at 705, n. 42, quoted in the majority opinion herein at p. 30). With both of these suggestions the Court was addressing the problem of *future* accumulations, not past overcollections, and proposing methods of *mitigating* (avoiding) future consequences.

3. The Majority Erred in Holding That the Rule Against Retroactive Ratemaking Could Be Abrogated in This Case on the Theory That Edison Had Enjoyed "Overcollections" During the Pendency of the Fuel Cost Adjustment Clause.

The majority makes this argument at pp. 18 to 22 of its opinion. It is in error in two respects: first that an "overcollection" can justify a retroactive refund order and second that there was "an overcollection."

A. An Assumed "Overcollection" of Revenues Over Costs Will Not Justify an Exception to the Rule Against Retroactive Refund Orders.

Pacific Telephone squarely holds to this effect. In that case, the Commission found that the utility's rates, as fixed in an order in 1958, had been unreasonably high from and after the date the Commission initiated its investigation in 1962. By an order entered two

years later, the Commission attempted to require the utility to refund these excessive revenues. In any number of different ways, this Court stated and restated that the Commission had no power whatever to make such an order, even though it was assumed that the utility would retain revenues that were excessive in the amount of $80 million.

City of Los Angeles I, in recognition of this authority, annulled, as we have seen, the Pacific Telephone rate* there being considered *before it became final.* Its stated reason for doing so was: "that the commission could not, even on the ground of unreasonability, require refunds of charges fixed by formal finding which became final." (7 Cal. 3d at 356.)

This principle has constitutional dimensions, which the majority ignores altogether. A refund of lawfully collected revenues—even though excessive—is a taking of property without due process of law (U.S. Const., Am. XIV; Cal. Const. Art. I, Sec. 7). *Board of Public Utility Commissioners v. New York Telephone Company,* 271 U.S. 23 (1926); see *City of Los Angeles II,* at pp. 697-70. Thus, if the Public Utilities Code permits the result reached in this case, it is repugnant to these constitutional principles.

B. The Assumption That There Was an "Overcollection" Is Not Supported by the Record.

Everyone in this case recognizes that until Decision No. 85731, utility rates in California were fixed on the basis of costs and revenues in an average year, including average weather conditions. Everyone further

*The rate order dealt with in *Pacific Telephone* was a different order from that dealt with in *City of Los Angeles I and II,* although both applied to the same company.

recognizes that since an average year rarely occurs, in some years actual costs will fall below the forecasts that were used in fixing rates, and in other years actual costs will exceed those forecasts. In the former case an "overcollection" occurs and in the latter an "undercollection." These circumstances are viewed with equanimity in the ratemaking world, because it is assumed that in the long run these "overcollections" and "undercollections" will even out.

The majority expresses shock at what it seems to perceive as some windfall to Edison and it attributes this "windfall" to the fuel cost adjustments. It is wrong on both points, and it falls into error because it select for examination only those years during which the fuel cost adjustment was in effect, totally overlooking the fact that the same method of ratemaking has been in effect since time immemorial. 1974 in particular happened to be the kind of year when "overcollections" were to be expected because of the weather. Absent the fuel cost adjustment and the escalating fuel prices that gave rise to it, Edison would have experienced a sizeable "overcollection" anyway. And if the escalating prices had existed without the fuel cost adjustment, base rate increases on the basis of average year forecasts would have been in order, again producing "overcollections." So it was the weather and not the fuel cost adjustment that caused the "overcollection."

Furthermore, one finds an "overcollection" only by ignoring the fact that the 1972 to 1976 period is but the tag end of a continuum that began when ratemaking began, during which time there have been many periods of both wet and dry weather creating both positive and negative fuel cost-revenue differen-

tials. Selecting a limited part of the continuum and making special provisions because that part has unusual characteristics is repugnant to the whole idea of basing rates on averages. Many years ago, when the shoe was on the other foot, the Commission denied rate relief to Edison in a period of severe drought that caused its rate of return to plummet. *Southern California Edison Co.*, 25 C.R.C. 475, 478 (1924):

> ". . . . we have come to the conclusion that the present year, although it will produce much less than the normal net revenue, should be treated as but one of the many years going to make up the average condition upon which rates should be based."

There is nothing in the record to suggest that the averaging process for fuel costs for *all* years prior to 1976 has not worked as everyone expected it to and that on balance there has been no "overcollection."

Moreover, it must be remembered that over the period that the fuel cost adjustments were in effect, Edison earned a *lower* rate of return on its property dedicated to public use than that found by the Commission to be the *minimum* reasonable rate of return. The fossil fuel expense savings realized during this period occurred alongside both related and unrelated increased expenses. What the Commission and the majority characterize as a "windfall" to Edison is nothing but a paper surplus in one pocket more than balanced by deficits in other pockets.

The majority does not advance its position by saying that the fuel cost adjustment was designed to enable Edison to "recover" its fuel costs (Opinion, pp. 7-9). Such is the case with *any* utility rate, as the

majority itself notes (Opinion, pp. 7-8). We have already seen that the concept behind the fuel cost adjustment and the fuel cost component of the "base" or "general" rate is the same—so much so that in the "general" rate increase granted to Edison by Decision 81919 on September 25, 1973, the fuel cost adjustment was folded into the base rate.

When the Commission approved the fuel cost adjustment procedure in Decision No. 79838 it was well aware that cost-revenue differentials will result in non-average years from rates based on average year forecasts. Had this been considered a problem, the Commission could have ordered the adjustments to be made on a recorded year basis as it did in the case of ECAC. It did not do so, because there was no thought that any such cost-revenue differential, up or down, would constitute a windfall or a remediable hardship to Edison.

4. The Majority Decision Leaves Any Rate That Is Affected by an Adjustment Clause Open for Retroactive Change Indefinitely.

A fundamental problem posed by the majority's holding is that billions of dollars in rate adjustments will never become final. There is no ratification procedure available in the Code by which the Commission at a Section 728 hearing can approve that which has gone before. Indeed, one of the points not discussed by the majority is the "general" rate increase in September 1973 wherein the Commission folded into Edison's base rate the fuel cost adjustment in effect at that time. The natural presumption ought to have been that the Commission was approving what had gone before. By now permitting the Commission to order

a refund based upon a cost-revenue differential accrued from the very beginning, the majority in effect says that no ratification of what has gone before is possible under the Code. This means that monies collected under any adjustment clause are always subject to readjustment at a later date. For example, while today's Commission believes that the ECAC is fair and reasonable, so did yesterday's believe that the fuel cost adjustment clause was fair and reasonable. If today's Commission can retroactively order refunds of amounts lawfully collected under the duly established rates provided for by fuel cost adjustments, tomorrow's commission can decide that utilities must refund all or some of the amounts lawfully collected under the duly established rates provided for by the ECAC. California utilities, therefore, would not know from this day on whether the amounts they are lawfully collecting will remain their property.

If adjustment clauses continue to be a way of life, as they now appear to be, with each passing year the amounts accrued by utilities subject to possible refund at a later point in time will get progressively greater. That billions of dollars will be placed in peril is demonstrated by the fact that the amounts collected by Edison alone as a result of fuel cost adjustments exceed a billion dollars. Such an element of uncertainty and peril will affect management, labor, lending institutions and the investing public. In the end, as the dissent points out (pp. 19-22) this can only result in increased costs to utilities reflected in increased rates to the people of this State.

5. The Majority Opinion Does Not Address at All the Fact That the Refund Order as Drawn Requires the Refund of Revenues Generated by Base Rates and Fails to Take All Energy Costs Into Account.

A. The Order Would Require Edison to Refund a Portion of Its Revenues Attributable to the Fuel Cost Component of Its Base Rate.

The fuel cost adjustment by itself did not produce an "overcollection." The actual cost of fuel exceeded the additional revenues derived from the fuel cost adjustment. It was the *combination* of revenues derived from the fuel cost adjustment *plus* the fuel cost component of the base rate that exceeded actual fuel costs. Thus the base rate, which the majority says is immune from retroactive change, contributed to the "overcollection" that the majority holds must be refunded *in toto*.

An example, admittedly oversimplified but accurate for purposes of this demonstration, will show what we mean. In considering this example one must keep in mind that the fuel expense savings in question were not caused by any deviation from the expected price per unit of fuel oil, gas or coal used in the fuel cost adjustment. Those forecasts turned out to represent no more than the actual price—perhaps even less. The fuel expense savings arose primarily from the purchase of fewer barrels of fuel oil than would have been required in an average year.

Let us suppose that the fuel cost component of Edison's base rate, insofar as it reflected the cost of fuel oil, was predicated on a price of $6 per barrel and an average year usage of 1000 barrels. This would create a cost component of $6000 to be reflected in the base rate. Assume further that in applying the fuel cost adjustment, a price of $10 per barrel was

used for the same average year usage of 1000 barrels. This would add $4 per barrel to the cost and result in a fuel cost adjustment sufficient to produce an additional $4000 of revenue. Thus the base rate plus the fuel cost adjustment would produce $10,000 of revenue.

Now, let us assume that only 800 barrels of fuel oil were used during the period in question. Total fuel oil costs were thus $8000, and there was an "overcollection" of $2000. The following table shows where that $2000 comes from.

Rate	Price Per Bbl	Forecast Usage	Revenues	Actual Usage	Actual Cost	"Over-Collection"
Base	$ 6	1000	$ 6,000	800	$4800	$1200
FCA	4	1000	4,000	800	3200	800
Combined	$10	1000	$10,000	800	$8000	$2000

Thus it can be seen that revenues generated by the fuel cost component of the base rate contributed $1200 to the $2000 "overcollection." Nevertheless, the Commission's order and the majority decision require a refund of the entire $2000.

The record before the Commission showed that more than $70 million of the so-called "overcollection" was attributable to the base rate in this manner. This fact was called to the attention of the Commission in the petition for rehearing (pages 22-23) and to this Court in the petition for hearing (page 20). No findings of fact on this important issue were made by the Commission* nor does the majority opinion consider this question in any respect.

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*The failure of the Commission even to consider this material issue in and of itself should void the order. Pub. Util. Code, § 1705; *California Motor Transport Co. v. Public Utilities Commission*, 59 Cal. 2d 270 (1963); *Northern California Power Agency v. Public Utilities Commission*, 5 Cal. 3d 370, 380 (1971); *City of Los Angeles II*, p. 694, fn. 30.

B. The Majority Incorrectly Assumes That the Refund Order Takes Into Account the Extra Cost to Edison of Above Average Amounts of Other Forms of Energy Which in Part Made Possible the Reduction in Its Consumption of Fossil Fuels.

The majority states (Opinion p. 17) that the refund order in this case will operate "in essentially the same way as . . . the new energy clause. . . ." Such is not the case. Under the new energy clause Edison's actual cost of all forms of energy is to be compared against revenues derived from all energy cost components in the rates charged. The refund order in this case compares only the actual cost of fossil fuels with the revenues derived from the fossil fuel cost component of the rates charged. Costs and revenues relating to other energy sources are ignored.

As noted by the majority (pages 12-13), a major reason for the reduced consumption of fossil fuels in 1972-1975 was the increased availability of hydroelectric power. What this means is that Edison generated and purchased more hydroelectric power than in an average year. Since the hydroelectric power cost component of Edison's rate was based on the amount generated and purchased in an average year, in these nonaverage years Edison's actual cost of hydroelectric power exceeded those revenues. If, as the majority concludes, there was an "overcollection" of revenues for fossil fuels, there was an "undercollection" of revenues for hydroelectric power. The Commission's order as affirmed by the majority wholly ignores this. That order thus would pass on to the rate payer the full amount of the reduced fossil fuel costs made possible by these

additional amounts of hydroelectric power, but would impose on Edison the added cost of obtaining them. This circumstance and others like it* leave Edison with an "undercollection" of approximately $50 million.** This circumstance was called to the attention of the Commission (petition for rehearing, pages 22-23) and this Court (petition for hearing, pages 20 and 40). Neither the Commission's findings of fact nor the majority opinion takes note of it in any respect whatsoever.

Conclusion.

The decision of the majority, if allowed to stand, will introduce uncertainty into the financial condition of every utility in this State, as the dissenting members of this Court as well as of the Commission observed. The majority decision exposes to retroactive change, with no apparent statute of limitations, every dollar collected by a utility under the application of any kind of automatic or semiautomatic rate adjustment provision even though approved by the Commission. All this seems to be done because the court is shocked by a phenomenon that it misconceives as an "overcollection" by Edison. Neither the factual premise nor the legal conclusion based thereon is sound.

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*Revenues actually derived from the fuel cost adjustment were reduced by franchise fees based on gross revenues and by uncollectibles and to that extent should not be refunded.

**There is some overlap between this figure and the $70 million figure mentioned under heading A above so that the combination of the two factors is somewhat less in their sum.

WHEREFORE, petitioner prays that a rehearing be granted.

Respectfully submitted,

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(Certificate of Service omitted in printing.)

APPENDIX K.

Decision No. 86085 (July 7, 1976).

Before the Public Utilities Commission of the State of California.

Investigation on the Commission's own motion into electric utility Fuel Cost Adjustment tariff provisions and procedures; and the changes, if any, that should be made to said tariff provisions and procedures. Case No. 9886 (Filed March 18, 1976).

Order Denying Rehearing and Modifying Decision No. 85731.

Petitions for rehearing of Decision No. 85731 have been filed by Southern California Edison Company (Edison) and Toward Utility Rate Normalization. The Commission has considered these petitions and is of the opinion that good cause for rehearing has not been shown to exist. However, two matters do require discussion.

Finding No. 12 in Decision No. 85731 provides in part that:

> ". . . The energy cost adjustment factor should be applied on a cents-per-kwhr basis only to sales above lifeline quantities."

By this sentence we meant to carry forward our discussion in Decision No. 85731, [page 48], where we stated:

> "Any collection debits would be developed as part of the energy cost adjustment factor and applied on a cents-per-kwhr basis only to sales above lifeline quantities."

Finding No. 12 should be modified to conform to that discussion.

In Decision No. 85731, Ordering Paragraph 2, we ordered our staff to make certain recommendations to us. No provisions were made for Edison to have notice of or an opportunity to respond to those recommendations. Edison objects. We will modify Decision No. 85731 to provide Edison an opportunity to reply to the staff recommendations. No other points require discussion.

THEREFORE IT IS ORDERED that:

1. Finding No. 12 of Decision No. 85731 is hereby modified as follows:

> "12. The overcollection credit should be applied on a uniform cents-per-kwhr basis to all appropriate sales and the credit should be specified separately. Any collection debits should be developed as part of the energy cost adjustment factor and applied on a cents-per-kwhr basis only to sales above lifeline quantities."

2. Decision No. 85731 ishereby modified by the addition of Ordering Paragraph 2a as follows:

> "2a. The staff shall provide copies of the recommendations ordered above regarding Southern California Edison Company to Southern California Edison Company. Southern California Edison Company shall have ten (10) days to respond to the staff recommendations."

3. Rehearing of Decision No. 85731, as modified above, is hereby denied.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 7th day of July, 1976.

D. W. HOLMES
President
LEONARD ROSS
ROBERT BATINOVICH
Commissioners

I dissent.
/s/ WILLIAM SYMONS, JR.
Commissioner

I will file a written dissent.
/s/ VERNON L. STURGEON
Commissioner

CERTIFIED AS A TRUE COPY
/s/ William R. Johnson
Executive Director Public Utilities
Commission State of California

COMMISSIONER VERNON L. STURGEON, DISSENTING

By Case No. 9886, opened March 18, 1975, we undertook an investigation into the electric utility fuel cost adjustment (fca) tariff provisions. The fca provisions were first authorized in March 1972 as an expeditious vehicle for the recovery of increases in fossil fuel expense. On April 27, 1976, the Commission issued Decision No. 85731 in which it was determined by the majority that, under the fca provisions utilizing average-year forecasts, the utilities were able to amass sizable overcollections; that is, fuel adjustment revenues in excess of actual fuel adjustment costs. We decided to change the fuel clause from one based on average-year forecasts to one based on recorded data. Over the dissents of Commissioner Symons and myself, the majority further determined that the overcollections were to be amortized over a period of three years. Southern California Edison Company (Edison) filed a petition for rehearing, reconsideration and stay on May 6, 1976. I would grant that request.

It is Edison's argument that, in issuing Decision No. 85731, the Commission has illegally engaged in retroactive ratemaking. This claim is meritorious. The Commission has, through the requirement for the amortization of overcollections set up a procedure for the establishment of future rates based, in part, on past earnings. As specifically recognized (Decision No. 85731 at [35]), those past earnings were lawfully collected under rates found by us to be just and reasonable. The error originally committed in Decision 85731 is continued by the majority today.

In *Pacific Tel. & Tel. Co. v. Public Util. Com.* (1965) 62 C.2d 634 the Supreme Court held that

this Commission lacked power to require refunds of "general rates already approved by it." (62 C.2d at 650.) In *City of Los Angeles v. Public Util. Com.* (1972) 7 C.3d 331 the same Court stated that:

> "To permit the commission to redetermine whether the preexisting rates were unreasonable as of the date of its order *and to establish new rates for the purpose of refunds* would mean that the commission is establishing rates retroactively rather than prospectively (7 C.3d at 357, emphasis added.)

The Commission, itself, has determined that:

> ". . . costs applicable to past periods are not properly includible in current operating expenses for rate fixing
>
> . . .
>
> Past defects (sic) may not be made up by excessive changes in the future nor may past profits be reduced by disallowance to future operating expense." (*App. of Pac. Tel. & Tel. Co.* (1949) 48 CPUC 823 at 836.)

This holding follows the teachings of the United States Supreme Court. Thus, in *Board of Public Utility Comrs. v. New York Teleph. Co.* (1926) 271 U.S. 23, 70 L.ed. 803 the Supreme Court stated that:

> "Past losses cannot be used to enhance the value of the property or to support a claim that rates for the future are confiscatory. Galveston Electric Co. v. Galveston, 258 U.S. 388, 395, 66 L.ed. 678, 692, 42 Sup. Ct. Rep. 351, Georgia R. & Power Co. v. Railroad Commission, 262 U.S. 625, 632, 67 L.ed. 1144, 1148, 43 Sup. Ct. Rep. 680. And the law does not require the com-

pany to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future. Newton v. Consolidated Gas Co. 258 U.S. 165, 175, 66 L.ed. 538, 547, 42 Sup. Ct. Rep. 264, Galveston Electric v. Galveston, supra, 396 (66 L.ed. 683, 42 Sup. Ct. Rep. 351); Monroe Gaslight & Fuel Co. v. Michigan Pub. Utilities Commission (D.C.) 292 Fed. 139, 147; Minneapolis v. Rand (C.C.A. 8th) 285 Fed. 818, 823; Georgia R. & Power Co. v. Railroad Commission (D.C.) 278 Fed. 242, 247, affirmed in 262 U.S. 625, 67 L.ed. 1144, 43 Sup. Ct. Rep. 680; Chicago R. Co. v. Illinois Commerce Commission (D.C.) P.U.R. 1922 C, 282, 277 Fed. 970, 980; Garden City v. Garden City Teleph. Light & Mfg. Co. 150 C.C.A. 25, P.U.R. 1917 B. 779, 236 Fed. 693, 696." (70 L.ed. at 812-813).

The above-stated legal proposition is unquestionably the law of the land. The remaining issue then is whether the Commission's action in Decision No. 85731 comes within this rule. As shown hereinafter that question must be answered in the affirmative.

In Decision No. 85731 the Commission recognized that retroactive ratemaking is precluded by law. Thus, after quoting from *Pacific Tel. & Tel. Co. v. Public Util. Com., supra,* 62 C.2d 634 the Commission concluded that:

> "This language clearly bars the reducing or refunding of revenues under rates which were lawfully and finally effective." ([Page 42]).

However, the Commission then indicated:

> "We intend to do neither. However, we see no prescription in the cases discussing retroactive ratemaking (and contrariwise we see authority) for reducing rates prospectively even though that reduction may be appropriate in part because of past performance. When we find overcollections we have the option of reducing rates or reducing the rate of return. (cf. City of Los Angeles v. Public Utilities 15 Cal. 3d 680, filed on December 12, 1975)." [Pages 42-43].

To the contrary, we cannot, based on the prior cited authority, reduce future rates because of past overcollections. The action in Decision No. 85731 constitutes retroactive ratemaking.

An attempt is made by the majority to distinguish the prohibition against retroactive ratemaking in a general rate proceeding from the instant "special" proceeding. Thus, it was indicated in Decision No. 85731 that:

> ". . . we hold the distinction between general rate revenues and fca revenues is so clear that there is a correspondingly clear distinction between fca increases and general rate increases." [Page 44].

That there is a distinction or difference between general rate increases and fca increases may be taken as true. However, such a determination by itself, does not afford any justification for permitting retroactive ratemaking when fca increases are involved. Stated otherwise, any distinction that may exist between general and special rates is irrelevant to the resolution of the question of whether the Commission can engage in retroactive ratemaking. The answer in either case is no.

It does not follow from the above that we are powerless to prevent Edison from reaping a windfall. One way open is simply to maintain the average year forecast fca until a complete weather cycle has occurred. In this way, the above-average wet years will be offset by below-average wet years in time. In any event, rehearing with respect to the present procedures should have been granted.

/s/ VERNON L. STURGEON
Vernon L. Sturgeon
Commissioner

San Francisco, California
July 7, 1976

APPENDIX L.

Decision No. 79838, Application Nos. 52987, 52988 (March 21, 1972).

Before the Public Utilities Commission of the State of California.

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for an order of the Public Utilities Commission of the State of California authorizing Applicant to adopt a Fuel Cost Adjustment provision, Part B of the Preliminary Statement, and approving an initial adjustment thereunder to be applicable to customers utilizing electric energy. Application No. 52987 (Filed November 5, 1971) (Amended December 16, 1971).

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for an order of the Public Utilities Commission of the State of California authorizing Applicant to increase rates to customers utilizing electric energy to reflect increases in the cost of fossil fuel above those contemplated in Decision No. 78802. Application No. 52988 (Filed November 8, 1971) (Amended December 16, 1971).

(Appearances Listed in Appendix 1).

Opinion.

The Southern California Edison Company (Edison) seeks to increase its rates for intrastate electric service by $15,700,000 annually to reflect increases in the cost of fossil fuel, and seeks authority to file an amendment to its tariff to include a fuel cost adjustment provision which would permit increases in rates at periodic times to reflect future increases in the cost of fuel. The two matters were consolidated for hearing.

After a due notice, three days of public hearings were held before Commissioner William Symons, Jr., and Examiner Robert Barnett. The matter was submitted on January 18, 1972, subject to the filing of statements of position by various parties, which have been received. For convenience, the issues raised by the parties will be discussed in three sections as follows: (1) the requested increase in rates of $15.7 million; (2) the requested fuel cost adjustment provision; and (3) the manner in which any authorized increase in rates should be spread among the various customer classes.

I

RATE INCREASE TO OFFSET INCREASES IN THE COST OF FUEL

In Decision No. 78802 dated June 15, 1971 in Application No. 52336, the Commission found reasonable a range in rate of return between 7.7 percent and 8.1 percent for Edison and authorized Edison to increase its rates for intrastate electric service by $105.5 million so that Edison might realize a rate of return of 7.9 percent for the test year 1972. The increase was based upon estimates of revenues and expenses that would be incurred in 1972. The estimate for cost of fuel in 1972 was based upon actual prices paid for fuel by Edison to its suppliers prior to the time Application No. 52336 was submitted for decision. Using those prices as a base the various witnesses in Application No. 52336 projected the cost of fuel through 1972 using projected estimates of customer demand and projected estimates of the amount of each kind of fuel that would be consumed to generate the electricity needed in 1972. After Decision No. 78802 was issued, the cost of fuel to Edison increased appreciably and new projections by Edison showed that electric usage would be reduced in 1972 and the amounts of fuel and the kinds of fuel used to generate electricity in 1972 would differ from prior estimates.

Edison's electric power is derived from interchanged power, purchased power, hydro power, nuclear fuel, and fossil fuels. The fossil fuels, gas, oil, and coal, are the concern of this case. The price of the fossil

fuels as of Decision No. 78802 was: gas, 34.4 cents per M^2 btu; oil, 63.1 cents per M^2 btu; and coal, 17.3 cents per M^2 btu. By December 1971 the prices of these three fuels had risen as follows: coal, 18.2 cents per M^2 btu; gas, 36.4 cents per M^2 btu; and oil, 72.4 cents per M^2 btu. The cost ratio between coal, gas, and oil is approximately 1:2:4.

The cost of fossil fuel to Edison is not solely a function of price; the fuel mix must also be considered. A generating plant that uses gas as an energy source will generate electricity at much lower costs than the same plant generating an equal amount of electricity but using oil as an energy source. To the extent that there is insufficient gas to meet Edison's generating requirements, oil will have to be used, thereby increasing Edison's fuel costs. Similarly, to the extent that coal-burning plants operate less efficiently than expected, the deficiency must be made up with electricity generated from gas and oil-burning plants. Thus, the fuel mix equation can cause a change in costs of fuel regardless of whether the cost of the individual fuels has gone up over a particular period of time. The evidence shows that as of Decision No. 78802 the fuel mix ratio for fossil fuel was as follows: gas, 44.8 percent; oil, 31.3 percent; and coal, 23.9 percent. As of December 1971, the estimate for 1972 was as follows: gas, 46.1 percent; oil, 30.5 percent; and coal, 23.4 percent.

In this proceeding Edison presented one witness, a consulting engineer, to substantiate the need for

an increase in rates of \$15.7 million to offset increased fuel costs. He sponsored the following results of operations exhibit:

Results of Operations
1972 California Jurisdictional

Item	(1) 1972 Adopted / Decision No. 78802	(2) 1972 Revised / (December) 1971	(3) Fuel Cost Adjustment / Increase Revenue	(4) 1972 Revised / for Fuel Adjustment	(5) Effect Rev. Act of 1971 / ADR & ITC	(6) 1972 Revised / for Fuel Adj. & Taxes
REVENUE, M^2 \$	899.0	867.5	15.7	883.2		883.2
EXPENSE, M^2 \$						
Production	229.0	240.5		240.5		240.5
Transmission	25.1	27.5		27.5		27.5
Distribution	51.4	53.3		53.3		53.3
Cust. Accts.	21.0	21.4		21.4		21.4
Sales	7.8	7.9		7.9		7.9
Adm. & General	57.0	65.5	0.1	65.6		65.6
Depreciation	99.1	100.5		100.5		100.5
Taxes, Other	86.9	85.5		85.5		85.5
Taxes, Income	88.0	61.6	8.0	69.6	(6.8)	62.8
Total Expense	666.2	663.7	8.1	671.8	(6.8)	665.0
NET REVENUE, M^2 \$	232.8	203.8	7.6	211.4	6.8	218.2
RATE BASE, M^2 \$	2,947	2,946		2,946		2,946
RATE OF RETURN %	7.90	6.92		7.18		7.41

( ) Denotes loss.

The witness explained that the first column of figures was a summary of earnings for Edison's California jurisdictional operations based on estimates of revenue, expenses, and rate base for 1972 adopted by the Commission in Decision No. 78802, plus revenue and expenses which were expected to result from the increase in California jurisdictional rates authorized by that decision.

The second column of figures shows the revised summary of earnings for 1972 based on estimates of revenue, expenses, and rate base revised as of December 1971. The third and fourth columns of figures show

the effect on Edison's operations if fuel cost increases which occurred since Decision No. 78802 are recovered in this offset proceeding. The resultant rate of return is shown as 7.18 percent on the bottom line of the fourth column.

The witness explained that column 5 adjusts the results in column 4 for the effect of the changes in the Federal Revenue Act of 1971 reflecting the use of asset depreciation range and investment tax credit. This results in a credit to income tax of $6.8 million. The net effect is to raise the 1972 revised rate of return of 7.18 percent prior to the credit to the rate of return of 7.41 percent after the credit, as shown in column 6 of the table.

The witness concluded that Edison needs an adjustment in its rates for increased fuel costs to provide partial relief for the sizeable deficiency in return now forecast for 1972.

A witness for the staff testified that due to the difference between the cost of coal and the cost of fuel oil, any reduction in the use of coal and corresponding increase in the use of fuel oil substantially increases the fuel expenses. The witness reviewed Edison's 1972 estimates and concluded that the estimate of generation from its coal plants should be increased, thereby reducing the fuel expense increase by $1.4 million, to $14.4 million. The witness assumed a different capacity factor for Edison's coal-burning plants but used the same volume of energy sales that Edison estimated. He said that Edison's exhibit shows that Unit #2 at Mohave is expected to be down for overhaul for May and June 1972, but that this overhaul has been postponed until 1973. Therefore, he used a capacity factor of

69.58 percent for these two months instead of the capacity factor of 22.44 percent and 20.87 percent used by Edison. This deferred maintenance will result in a fuel saving of approximately $380,000. The balance of the $1.4 million saving results from his using different load factors in determining the output of Edison's Four Corners plant; he used 83 percent as compared to 80 percent used by Edison.

The staff proposes a billing factor of .031 cents per kilowatt-hour. This billing factor is expected to raise $14.3 million. The difference between $14.4 million in cost increase and $14.3 million increase in revenue is due to rounding the various computations. Edison had the same result. Its costs were estimated at $15.8 million, but its proposed billing factor of .034 cents per kilowatt-hour would raise only $15.7 million.

The staff reviewed the results of operation study submitted by Edison and this review indicates that Edison's rate of return for 1972 estimated will not exceed the lower level of the zone of reasonableness set forth in Decision No. 78802.

The California Manufacturers Association (CMA) takes the position that to the extent that any increase in rates is permitted to offset the increased cost of fuel, such increase should be reduced by the amount of the income tax reduction of $6.8 million as shown in column 5 of the results of operation study. The CMA's position shows the shortcomings of an offset proceeding such as this one. It points out that only one element of cost is being considered among numerous cost factors which have changed since the last rate proceeding. However, if a fuel cost offset proceeding is to achieve its primary purpose, which is to forestall

a general rate case which would probably lead to even greater increases, the proper criterion for determining whether to grant or deny the increase is the effect on the previously found reasonable rate of return. Within this concept, the fact of reduced tax expense is considered to determine if the fuel cost increase will cause Edison to earn more than the lower range of rate of return previously authorized by this Commission; it is not considered as a means of reducing the fuel cost increase. The evidence persuades us that the fuel cost increase requested by Edison will not increase Edison's rate of return to 7.7 percent, but will only increase Edison's rate of return to 7.41 percent. We are persuaded that the staff estimate of fuel mix is more accurate than Edison's, and we will authorize a revenue increase of $14.3 million.

II
THE FUEL CLAUSE

Edison proposes to add the following fuel cost adjustment billing factor to its tariff to provide for increases and decreases in the cost of fuel to Edison:

1. Bills rendered under the rate schedules and special contracts contained herein shall be increased or decreased by an adjustment amount related to increases or decreases in the cost per million btu of fuel used in the utility's generating plants as set forth below.
2. An adjustment amount per kilowatt-hour sold shall be determined to be applied to service rendered on and after the effective date and continuing thereafter until the next such adjustment amount becomes effective in accordance

herewith. A forecast period is the 12-month period commencing with the expected effective date of each adjustment amount per kilowatt-hour. Such fuel cost adjustment billing factor shall not be revised more often than once every three months.
3. The amount of gas fuel shall be the quantity of gas in millions of btu expected to be received from each supplier during the forecast period under average temperature conditions. The amount of coal fuel shall be the quantity of coal in millions of btu which can be utilized in available coal-fired generating facilities. The amount of oil fuel shall be the quantity of oil in millions of btu equal to the difference between (a) the total fossil fuel requirements in the forecast period under normal conditions of temperature and precipitation, and (b) the fossil fuel requirements in the forecast period expected to be supplied by gas and coal fuels.
4. The base rates reflect a cost of fossil fuel of 39.3 cents per million btu. The adjustment amount per kilowatt-hour sold shall be determined as follows: The amount of the total fuel cost adjustment shall be determined by calculating the total estimated annual amount of fossil fuel expense (based on prices of fuels on or before the first day the proposed adjustment is to be effective and the fuel availability for the twelve-month period commencing with such day) and deducting therefrom the corresponding cost of the same quantity of heat energy utilizing the price levels and relative availability of fuels which form the basis for the then

existing base rates. The total fuel cost adjustment for the system would then be allocated to customers by using a unit fuel cost adjustment billing factor (rounded to the nearest 0.001¢) and applying such factor to the quantities of energy billed.

5. The price of gas fuel shall be each applicable rate or contract price, expressed in cents per million btu, in effect on or before the first day of the forecast period divided by the quantity of gas expected to be received from such supplier during the forecast period. The price of coal fuel shall be the invoice price for such fuel, expressed in cents per million btu, as of the first day of the forecast period. The price of oil fuel shall be the average cost of each type of inventory (determined in accordance with the Uniform System of Accounts) on the first day of the forecast period for the amount of such oil fuel in inventory and the price of any oil fuel required in excess of such inventory shall be at the price (including sales and use taxes) of the most recent delivery of such fuel.
6. The adjustment amount to be added to or subtracted from each bill shall be the product of the total kilowatt-hours for which the bill is rendered multiplied by the adjustment amount per kilowatt-hour sold.
7. Each adjustment amount per kilowatt-hour sold shall be filed with the California Public Utilities Commission on or before the thirtieth day preceding the date on which such adjustment amount becomes effective.

Briefly, the fuel clause provides that when changes in the cost of fuel or the fuel mix increase the energy cost to Edison, rates go up; when changes in the cost of fuel or the fuel mix decrease the energy cost to Edison, rates go down. The clause would be triggered when the change is .001 cent per kilowatt-hour, or more; each .001 cent per kilowatt-hour represents about $460,000 at current operations. Neither increases nor decreases are automatic; they require Commission approval.

The arguments in favor of the fuel clause include: (1) in an inflationary period with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so that its ability to function is not impaired; (2) because fuel costs are at least 20 percent of Edison's total costs, an expedited proceeding to recover these increases will lessen the frequency of general rate cases; and (3) the provision enhances a utility's position in the financial community. Although the fuel clause would be triggered if fuel costs went down, it is apparent that Edison's proposal is based on the expectation that fuel costs will continue to rise.

The principal arguments against Edison's fuel clause are: (1) it represents an abdication of the Commission's regulatory function; (2) it denies the ratepayer the opportunity to participate in a public hearing and to develop a full and complete record; (3) it has an inflationary effect on the economy; (4) frequent rate changes would result and this is undesirable; (5) there would be no incentive for the utility to attempt to obtain an economical supply of fuel nor to increase efficiency and absorb all or part of fuel cost increases; (6) it ignores other rate-making factors usually con-

sidered by the Commission in spreading rates, such as competition, characteristics of use, and public benefit; and (7) it segregates and places emphasis on only one factor in setting rates, fuel cost, and ignores possible savings and efficiencies that have occurred in other portions of the utility's operation.

Most of the arguments usually made in opposition to fuel clauses are not valid, in our opinion, when applied to Edison's proposal. Edison's proposal has substantial benefits in its expedited procedure and in its avoidance of general rate cases. Any disadvantages in the proposal appear to us to be either minimal or merely theoretical.

The fuel clause cannot be criticized on the ground that it is an abdication of regulatory responsibility. The Commission retains full control of each request for change in the fuel cost adjustment billing factor as no change will become effective without opportunity for staff review and until Commission approval. We expect the staff to take all the time necessary to review and evaluate any proposed fuel clause adjustment in the light of the supporting data submitted by Edison and other data accumulated by the staff, plus any objections to such change that may be filed by Edison's customers or other interested parties.

The criticism that the fuel clause will decrease the incentive of Edison to keep costs down appears to be more theoretical than substantial as fuel costs only represent about 20 percent of Edison's operating costs. It is apparent that Edison, with or without a fuel clause, must be continually maximizing its efficiency and economy of operation if it is to achieve satisfactory earnings performance on a sustained basis. The areas of costs in which the fuel clause would operate are

areas in which the utility has relatively little control once the choice of generating facility is made, the fuel character is determined by governmental regulations or other environmental considerations, and long-term fuel supply arrangements are set. Additionally, the fuel cost adjustment procedure proposed by Edison takes into account any offsetting increased efficiency in Edison's generating facilities. By developing the cost of generation in terms of cents-per-million btu of energy to which the revised rates are to be applied each time a change in the fuel cost adjustment billing factor is proposed, and then computing the changes in fuel cost per kilowatt-hour of generation, full consideration is given to any increases or decreases in the efficiency of Edison's generating facilities. Moreover, specific offsetting cost changes in other areas of Edison's operations will be considered by the staff in its evaluation of Edison's advice letter proposal to assure that Edison's proposed rates will not increase its earned rate of return above the lower limit of its previously approved range of rate of return. The reason that we authorized a range in rate of return rather than a fixed percentage is to avoid rate adjustments when costs fluctuate within the range.

The contention that fuel clauses which reflect changes in fuel costs directly in a utility's rates are inflationary is not valid as such increases merely reflect the effect of past price inflation on the cost of fuel, and the effect of a dwindling supply of lower cost fuels acceptable from the standpoint of environmental protection regulations. As a matter of fact, the Price Commission has specifically excepted from its suspension of price increases and from its certification requirements "any price increase resulting from the pass-through of specific

allowable costs, including . . . fuel costs . . ." (Sec. 300.16(c) Economic Stabilization Act of 1970, as amended, Public Law 92-210).

Finally, the fuel clause that we are approving herein is not automatic; it goes into effect only after being initiated by advice letter, being thoroughly reviewed by the staff, and being approved by the Commission. Although there was much talk in the hearings of a thirty-day period after which rates would be raised because of a fuel cost adjustment, we wish to make it clear that there is no automatic thirty-day provision in this fuel clause. Rates will go into effect upon Commission approval which might take much longer than thirty days, depending upon the evidence submitted with the proposed rate increase and the amount of opposition to it. While it is not contemplated that public hearings will be held in reference to rate increases based upon the fuel clause, the Commission retains the power to order public hearings if needed in any particular case.

The staff has recommended that an additional paragraph be added to Edison's fuel clause to provide for the handling of possible refunds. The paragraph states: "Any refund from a fuel supplier shall be refunded with 7 percent interest to the utility's customers. A refund plan shall be filed with the California Public Utilities Commission when such refunds have accumulated to a total of $1,000,000 or more." In our opinion this paragraph is necessary to protect the ratepayer and we will include it.

We need not elaborate on other objections. For the reasons stated above, we will authorize the fuel cost adjustment clause.

III
RATE SPREAD

Edison requests that any increase in rates based upon increases in cost of fuel be spread to all customer groups, with minor exceptions not pertinent here, on the basis of a uniform cents per kilowatt-hour increase. CMA and other large industrial users advocate a uniform percentage of revenue increase. The staff supports Edison's proposal. Although there is no evidence in the record as to the effect of these alternate proposals on large users, there is no doubt that under Edison's proposal the electric bills of large users will increase substantially more proportionally than the electric bills of small users.

Both CMA and the staff point out the irony of each other's position. The staff claims "It is ironic that in both the 1968-1969 and 1970-1971 rate increase applications (CMA and Kaiser Steel Corporation) took a firm position in opposition to uniform percentage increase to all customer groups." On the other side, CMA asserts "This proceeding is not without its touch of irony. When CMA has urged that industrial rates be more closely related to the cost of providing the service, CMA has been admonished by Edison, the staff, and the Commission that cost is not the only rate-making factor. Now that Edison seeks to invoke a fuel cost adjustment clause, cost is considered by Edison and the staff to be not only the principal rate-making factor but the sole rate-making factor for over $15,000,000 of additional revenues."

We have considered the arguments pro and con and are persuaded that Edison's position is the soundest. We are persuaded because fuel costs have always been

considered by this Commission to be energy-related. A review of staff and Edison exhibits in the 1970 rate proceeding shows that fuel costs were classified energy-related. In Decision No. 78802, at page 21, it is stated, "In this case, the staff classified fuel costs as energy-related . . ." And the Commission accepted that characterization. Also, in Decision No. 79366 dated November 22, 1971 in Application No. 52800, we authorized San Diego Gas & Electric Company to offset increases in fuel oil costs by applying a uniform energy charge to each kilowatt-hour sold. In Decision No. 55720 dated October 22, 1957 in Application No. 38811, we authorized Pacific Gas & Electric Company to increase rates, and said, "It is appropriate that changes in energy cost be reflected in all charges per unit of energy, thus directly assigning increased production costs to the energy produced." (55 CPUC 801, 809.)

The large industrial users will not be overburdened by this method of increasing costs. In Decision No. 78802 we found that the large industrial customer groups contribute a rate of return of 6.6 percent as against 7.4 percent for domestic customers and 11.8 percent for lighting and small power customers.

We have not been cited to, nor have we found, any other jurisdiction that has considered increases based upon increased costs of fuel that has granted offsets on a basis other than uniform application of a cents per kilowatt-hour. Our research shows that whenever the problem has come up in California with either publicly owned utilities or privately owned utilities, fuel costs offsets have always been based upon a cents per kilowatt-hour increase.

Findings of Fact

1. In Decision No. 78802 the Commission found reasonable a range in rate of return between 7.7 percent and 8.1 percent for Edison and authorized Edison to increase its rates for intrastate electric service by $105.5 million so that Edison might realize a rate of return of 7.9 percent for the test year 1972.

2. After Decision No. 78802 was issued the cost of fuel to Edison increased appreciably, and new projections showed that electric usage would be reduced in 1972 and the amounts of fuel and the kinds of fuel used to generate electricity in 1972 would differ from prior estimates. Coal increased from 17.3 cents per M^2 btu to 18.2 cents; gas from 34.4 cents per M^2 btu to 36.4 cents; and oil from 63.1 cents per M^2 btu to 72.4 cents.

3. Based upon revised estimates, Edison's rate of return for 1972 will be approximately 6.9 percent; with the fuel cost adjustment authorized herein, Edison's rate of return is estimated to be approximately 7.2 percent. When certain tax adjustments are made the rate of return approximates 7.4 percent.

4. The staff estimate for the capacity factor of Edison's coal-burning plants is reasonable. In 1972 estimated, [*sic*] the amount necessary to offset additional fuel costs to Edison is $14.3 million. A billing factor of .031 cents per kilowatt-hour for all energy sold is reasonable to recover the $14.3 million.

5. Fuel costs are energy-related and should be recovered by applying a uniform energy charge to each kilowatt-hour sold.

6. Edison's proposed fuel cost adjustment billing factor will be adopted because (1) in an inflationary

period with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so that its ability to function is not impaired; (2) because fuel costs are at least 20 percent of Edison's total costs, an expedited proceeding to recover these increases will lessen the frequency of general rate cases; and (3) the provision enhances a utility's position in the financial community.

7. Edison should be required to submit reports covering the reasonableness of the prices it pays for fossil fuels and the recorded, adjusted and estimated results of operations for its California jurisdictional operations.

8. The adopted fuel clause will not occasion an abdication of regulatory responsibility; nor will it decrease the incentive of Edison to keep costs down; nor will it be inflationary as any price increases brought about by use of the fuel clause merely reflect the effect of past price inflation on the cost of fuel.

The Commission concludes that the fuel clause should be authorized and that an increase in rates should be granted as set forth in the order which follows.

So as not to unduly lengthen this opinion, we have not set forth findings pursuant to regulations of the Price Commission as, in this case, we do not feel such findings are required. However, we did take evidence in these matters and are prepared to issue such findings, if needed, by supplemental order.

ORDER

IT IS ORDERED that Southern California Edison Company is authorized to file with the Commission. on or after the effective date of this order, revised tariff schedules, with changes in rates, charges and

conditions as set forth in Appendix 2 attached hereto. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be on not less than five days' notice to the public and to the Commission.

IT IS FURTHER ORDERED that Southern California Edison Company shall file a Results of Operation Report on the ensuing year's operation by October 31 of each year and a report on the previous year's recorded and adjusted operations by March 31 of each year including in the latter report a showing on the reasonableness of the prices it pays for fossil fuels.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 21st day of March, 1972.

J. P. VUKASIN, JR.
Chairman
WILLIAM SYMONS, JR.
THOMAS MORAN
VERNON L. STURGEON
Commissioners

I will file a dissent.
/s/ D. W. HOLMES

I will file a concurring opinion.
/s/ THOMAS MORAN

APPENDIX 1

APPEARANCES

Rollin E. Woodbury, Robert J. Cahall, and William E. Marx, by *William E. Marx,* Attorney at Law, for applicant.

Kenneth M. Robinson, Attorney at Law, and *George B. Scheer,* for Kaiser Steel Corporation, protestant.

Brobeck, Phleger & Harrison, by *Robert N. Lowry* and *Gordon E. Davis,* Attorneys at Law, for California Manufacturers Association; *Alan R. Watts,* Attorney at Law, for City of Anaheim; *Frederick I. Fox,* Chickering & Gregory, by *Sherman Chickering, C. Hayden Ames, Donald J. Richardson, Jr.,* and *Edward P. Nelson,* Attorneys at Law, for San Diego Gas & Electric Company; *R. F. Smith* and *W. C. Leist,* for Union Carbide Corporation-Linde Division; *Thomas H. Burcham,* Attorney at Law, for California Farm Bureau Federation; *Robert W. Russell* and *Manuel Kroman,* for Department of Public Utilities and Transportation, City of Los Angeles; *Arthur Kugel,* for City of Riverside; *K. R. Edsall, R. W. McKinney,* and *F. A. Peasley,* Attorneys at Law, for Southern California Gas Company; *O. T. Jones* and *E. R. Rhodes,* for Monolith Portland Cement Company; *Louis Possner,* for Bureau of Franchises and Public Utilities, City of Long Beach; *Paul P. Hendricks,* for City of Vernon; *John E. Anderson,* for Metropolitan Water District, interested parties.

Cyril M. Saroyan, Attorney at Law, and *Norman R. Johnson,* for the Commission's staff.

APPENDIX 2

RATES—SOUTHERN CALIFORNIA EDISON COMPANY

Applicant's rates, charges and conditions are changed to the level or extent set forth in this appendix.

PRELIMINARY STATEMENT (contd.)

H. FUEL COST ADJUSTMENT BILLING FACTOR

1. Bills rendered under the rate schedules and special contracts contained herein shall be increased or decreased by an adjustment amount related to increases or decreases in the cost per million Btu of fuel used in the utility's generating plants as set forth below.

2. An adjustment amount per kilowatt-hour sold shall be determined to be applied to service rendered on and after the effective date and continuing thereafter until the next such adjustment amount becomes effective in accordance herewith. A forecast period is the 12-month period commencing with the expected effective date of each adjustment amount per kilowatt-hour. Such fuel cost adjustment billing factor shall not be revised more often than once every three months.

3. The amount of gas fuel shall be the quantity of gas in millions of Btu expected to be received from each supplier during the forecast period under average temperature conditions. The amount of coal fuel shall be the quantity of coal in millions of Btu which can be utilized

in available coal-fired generating facilities. The amount of oil fuel shall be the quantity of oil in millions of Btu equal to the difference between (a) the total fossil fuel requirements in the forecast period under normal conditions of temperature and precipitation, and (b) the fossil fuel requirements in the forecast period expected to be supplied by gas and coal fuels.

4. The base rates reflect a cost of fossil fuel of 40.0 cents per million Btu. The adjustment amount per kilowatt-hour sold shall be determined as follows: The amount of the total fuel cost adjustment shall be determined by calculating the total estimated annual amount of fossil fuel expense (based on prices of fuels on or before the first day the proposed adjustment is to be effective and the fuel availability for the twelve-month period commencing with such day) and deducting therefrom the corresponding cost of the same quantity of heat energy utilizing the price levels and relative availability of fuels which form the basis for the then existing base rates. The total fuel cost adjustment for the system would then be allocated to customers by using a unit fuel cost adjustment billing factor (rounded to the nearest 0.001¢) and applying such factor to the quantities of energy billed.

5. The price of gas fuel shall be the average of each applicable rate or contract price, expressed in cents per million Btu, in effect on or before the first day of the forecast period weighted by the quantity of gas expected to

be received from such supplier during the forecast period. The price of coal fuel shall be the invoice price for such fuel, expressed in cents per million Btu, as of the first day of the forecast period. The price of oil fuel shall be the average cost of each type in inventory (determined in accordance with the Uniform System of Accounts) on the first day of the forecast period for the amount of such oil fuel in inventory and the price of any oil fuel required in excess of such inventory shall be at the price (including sales and use taxes) of the most recent delivery of such fuel.

6. The adjustment amount to be added to or subtracted from each bill shall be the product of the total kilowatt-hours for which the bill is rendered multiplied by the adjustment amount per kilowatt-hour sold.

7. Each adjustment amount per kilowatt-hour sold shall be filed with the California Public Utilities Commission on or before the thirtieth day preceding the date on which such adjustment amount becomes effective.

8. Effective for service rendered on and after May 1, 1972, the adjustment amount per kilowatt-hour sold is 0.031 cents per kilowatt-hour.

9. Any refund from a fuel supplier shall be refunded with 7% interest to the utility customers. A refund plan shall be filed with the California Public Utilities Commission when such refunds have accumulated to a total of $1,000,000 or more.

SCHEDULES NOS. A-1, A-2, A-3, A-4, A-5 and A-6
SPECIAL CONDITIONS

7. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. A-8
SPECIAL CONDITIONS

10. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULES NOS. D-1, D-2, D-3, D-4 and D-5
SPECIAL CONDITIONS

Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. D-6
SPECIAL CONDITIONS

1. Seasonal Service: For summer cottage customers and others who normally require service for only part of the year, this service is applicable only on annual contract.

2. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. DWL
SPECIAL CONDITIONS

5. Fuel Cost Adjustment: The rates above are subject to adjustments as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to 37 kwhr per month for each lamp served.

SCHEDULE NO. LS-1
SPECIAL CONDITIONS

4. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to 29 kwhr per month per 1,000 lumens for incandescent lamps and to 10 kwhr per month per 1,000 lumens for mercury vapor lamps.

SCHEDULE NO. LS-2
SPECIAL CONDITIONS

6. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to the kwhr shown below:

Type of Service	Kwhr per Kw Per Month
All Night Multiple	355
All Night Series	462
Midnight Multiple	180
Midnight Series	233

SCHEDULE NO. OL-1
SPECIAL CONDITIONS

7. Fuel Cost Adjustment: The rates above are subject to adjustments as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to 10 kwhr per month per 1,000 lumens.

SCHEDULE NO. P-1
SPECIAL CONDITIONS

7. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. PA-1
SPECIAL CONDITIONS

11. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. PA-2
SPECIAL CONDITIONS

6. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

SCHEDULE NO. TC-1
SPECIAL CONDITIONS

1. Voltage: Service will be supplied at one standard voltage not in excess of 240 volts or, at the option of the utility, at 240/480 volts, three wire, single phase.
2. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

COMMISSIONER THOMAS MORAN, Concurring.

I concur.

However I do so reluctantly as in my judgment the inclusion in this decision of a "fuel clause" is detrimental to good regulation.

To permit a utility to obtain a major increase in rates without a hearing and careful scrutiny, and consideration by this Commission of the necessity for such increase, inevitably reduces the effectiveness of the Commission in controlling the charges collected from the ratepayers. I reluctantly agree to the fuel clause

only because this Commission lacks sufficient staff personnel to permit us to hold a hearing on every request by a utility for a substantial increase in rates.

The workload of this Commission inevitably will continue to increase at least during the next few years, even if the federal government discontinues its inflationary policies, because of the increasing attention which this Commission must give to ecological considerations. The utilities and transportation companies regulated by this Commission exact from the people of California sums in excess of those collected in taxes by the entire state government. Because the utilities and transportation companies are dealing in goods and services which are for the most part necessities of life, the people of California realistically have no more opportunity to avoid such charges than they have to avoid paying state taxes. It is not economy to risk permitting utilities and transportation companies to charge each year millions of dollars more than they really need, merely to achieve a few hundred thousand dollars of so-called "salary savings."

/s/ THOMAS MORAN
Thomas Moran, Commissioner

Dated: March 21, 1972
San Francisco, California

D. W. HOLMES, COMMISSIONER, Dissenting:

I dissent from that part of the opinion which allows Edison to increase rates by advice letter filings to offset its costs of fuel. One of the criticisms of the so-called "fuel clause" listed on page 10 of the majority opinion is particularly cogent in its suggestion that the quick and frequent increases portended by the "fuel clause" will act as a disincentive to economical operation and the economical acquisition of fuel supplies by Edison. Edison, one of the largest electric utilities in our Nation, should be given every reason and motivation to make the most effective use of its bargaining strength and managerial and technical expertise, to the end that the ratepayers will receive good service at the least possible cost.

The other real problem that is involved in establishing this procedure is that it precludes public hearings in situations that have had and will have an extremely significant impact on the ratepayers of California.

It should be noted that in dissenting I concur in and echo the sentiments of Robert Barnett, the Examiner who heard the case. In a memorandum to the Commission dated March 2, 1972, he stated, in part:

> "I do not agree with that part of the proposed decision which authorizes a fuel cost adjustment clause; I would deny any fuel clause."

/s/ D. W. HOLMES
Commissioner

Dated at San Francisco, California, March 21, 1972

Decision No. 79898 (April 4, 1972).

Before the Public Utilities Commission of the State of California.

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for an order of the Public Utilities Commission of the State of California authorizing Applicant to adopt a Fuel Cost Adjustment provision, Part B of the Preliminary Statement, and approving an initial adjustment thereunder to be applicable to customers utilizing electric energy. Application No. 52987 (Filed November 5, 1971) (Amended December 16, 1971).

In the matter of the application of SOUTHERN CALIFORNIA EDISON COMPANY for an order of the Public Utilities Commission of the State of California authorizing Applicant to increase rates to customers utilizing electric energy to reflect increases in the cost of fossil fuel above those contemplated in Decision No. 78802. Application No. 52988 (Filed November 8, 1971) (Amended December 16, 1971).

Order Modifying Decision.

It appears necessary to correct an inadvertent omission of Special Condition 9 of Schedule No. A-7 from Appendix 2 of Decision No. 79838.

IT IS ORDERED that Appendix 2 of Decision No. 79838 is modified as set forth in Appendix 2 of this decision. In all other respects, Appendix 2 of Decision No. 79838 is unchanged.

The effective date of this order shall be the date hereof.

Dated at San Francisco, California, this 4th day of April, 1972.

J. P. VUKASIN, JR.
Chairman

WILLIAM SYMONS, JR.
THOMAS MORAN
VERNON L. STURGEON
Commissioners

I abstain.
D. W. Holmes, Commissioner

Certified as a True Copy
Assistant Secretary
Public Utilities Commission
State of California

APPENDIX 2

RATES—SOUTHERN CALIFORNIA EDISON COMPANY

The following is added to Appendix 2 of Decision No. 79838:

SCHEDULE No. A-7

SPECIAL CONDITIONS

9. Fuel Cost Adjustment: The rates above are subject to adjustment as provided for in Part H of the Preliminary Statement. The applicable fuel cost adjustment billing factor set forth therein will be applied to all kwhr billed under this schedule.

APPENDIX M.

Commission's Answer to Petition for Rehearing before California Supreme Court.

No. 23500

SOUTHERN CALIFORNIA EDISON COMPANY,

Petitioner,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, D. W. HOLMES, WILLIAM SYMONS, JR., VERNON L. STURGEON, LEONARD ROSS, and ROBERT BATINOVICH, the members of and constituting said Public Utilities Commission,

Respondents.

JANICE E. KERR
HECTOR ANNINOS
TIMOTHY E. TREACY

5066 State Building
San Francisco, California 94102

Attorneys for the Public
Utilities Commission of the
State of California

April 24, 1978

SUBJECT INDEX

(* Page references omitted in printing.)
(** Certificate of Service omitted in printing.)

I.

PRELIMINARY

Petitioner seeks rehearing of the decision of this Court affirming the order of the respondent Commission which requires petitioner to amortize over 36 months by billing credits to its customers substantial overcollections generated by operation of petitioner's "fuel cost adjustment clause." The facts underlying the Commission's decision are discussed at length in this Court's decision, as well as the petition and answer thereto of respondents.

It is enough to emphasize that in 1972 the Commission recognized the impact of substantial increases in the cost of petitioner's fossil fuel used to produce electricity and authorized a procedure whereby Edison could seek periodic rate adjustments to reflect *future increases* in the cost of fuel. Since future increases were the measure, they necessarily had to be estimated and, for this purpose, "average year" conditions were assumed. As this Court recognized, the average year conditions upon which the rate increases were predicted did not obtain and in consequence Edison collected substantial revenues to reflect assumed fossil fuel expenses which, admittedly, it did not incur from 1972 through 1974. Faced with public reaction to these accelerating collections of revenues for fuel expenses not actually incurred, the Commission was forced to revise the fuel adjustment procedure to more accurately match actual expenses and cost. It was the Commission's disposition of the overcollections which has prompted the controversy between petitioner and respondent.

This Court also recognized that the respondent Commission was forced by public concern and reaction to revise

the fuel adjustment clause which had led to such distorted results. Such revision was necessary for the Commission to maintain its public credibility as a viable regulatory agency. Similarly, the Commission was faced with the maintainance of its credibility in disposing of the overcollections. The other major electric utilities in this State restored overcollection to their customers received under fuel adjustment clauses similar to that of petitioner. Petitioner alone treated these overcollections as profit and, determined to retain them as such, sought review of the Commission's determination that the public interest required that such overcollections be amortized over a three-year period as billing credits. This Court affirmed that determination of the respondent Commission.

II.

PETITIONER'S ARGUMENTS

Edison's petition for rehearing makes the following arguments:

First, it is asserted by petitioner at the outset and conclusion of its petition that this Court's decision will result in financial uncertainly leading to the down grading of "all" California utility bonds. There is no evidence before this Court to support such a contention with respect to either Edision, or any other California utility. Edison has booked the overcollection as income in the years received and has since duly noted the pendency of this litigation and potential impact of the Commission's order in all its financial reports. The probability of an adverse resolution has not jeopardized Edison's financial standing, or its ability to sell securities or raise its dividend rate on

various occasions since the inception of the fuel adjustment clause. (It is not asserted in any of petitioner's financial statements that it will be required to reduce the increased dividends in view of this Court's affirmance of the Commission's order.)

Similarly, it cannot be maintained that either the Commission's order, or the order of this Court affirming it will cast doubt as to the stability of future rate increases. The Commission's decision dealt with an extraordinary situation and resolved the issues in a well-reasoned decision conforming to the requirements of law and precedents of this Court.

Second, petitioner repeats a contention made to both the Commission and this Court that since its earned rate of return during the period involved never exceeded the rate of return authorized by the Commission, it ought to be left with the overcollections derived from the operation of the fuel adjustment clause. The Commission's decision and this Court's opinion have fully addressed this contention. It can only be emphasized that the fuel adjustment clause was proposed by petitioner, and was intended to compensate petitioner for fuel costs only. Regardless of petitioner's hindsight consideration, it was never intended by either petitioner or the Commission to implement or impact in any way petitioner's rate of return. Ironically, the rate of return level to which petitioner addresses itself in the petition is itself a figure adjusted to reflect an earnings level for average year conditions, thus discounting the impact of the fuel clause overcollections upon its net income for purposes of completing a rate of return, as distinct from the earnings declared to the stockholders, which, this Court observed, reached record levels in the years in question.

Third, petitioner raises another old argument, an asserted failure by the Commission to consider the impact of all components of petitioner's energy costs. This argument is similar to the rate of return argument; that is, petitioner seeks by hindsight to confuse other items of petitioner's costs and revenues with the fuel adjustment clause which was designed to consider increases in fossil fuel costs only.

Thus at pages 23 and 24 of the petition, petitioner contends that a portion of its revenues attributable to "base" rates, i.e., revenues related to fuel costs in effect prior to the increased costs covered by the fuel adjustment clause, are affected by the amortization and that the Commission has also failed to consider other energy costs.

These arguments were originally addressed to the Commission and later to this Court. The Commission used a simple test to measure the performance of the fuel adjustment clause: revenues received under the rate increases triggered by the clause versus actual increases in fossil fuel costs. Other expenses to petitioner, including "base" fuel costs, i.e., non-fuel adjustment costs, simply were not a part of the fuel adjustment clause. The argument to allocate revenues between fuel costs adjustment rates and base rates overlooks the fact that the "overcollections" quantified by the Commission were calculated according to factors in the fuel adjustment clause. "Overcollections" might have been experienced with respect to non-fuel clause established rates, i.e., so called "base" rates; however, these constitute no part of the "overcollections" determined by the Commission, which are restricted to only the difference by which fuel clause adjustment revenues exceeded actual fuel clause adjustment costs as calculated under the fuel adjustment clause.

Petitioner also reargues at length the issue of retroactive ratemaking and the distinction between general ratemaking and those fixed in special proceedings, such as under the fuel clause adjustment procedure. Both the Commission in its decision and this Court in its opinion have carefully considered the question of retroactivity and the distinction between general ratemaking and special rates itself carefully drawn in the *City of Los Angeles* decisions of this Court. With respect to those latter decisions, there is no difference between inflated tax expenses and inflated fuel expenses, even though the latter may have been completely unintentional and caused by unanticipated weather conditions. The Commission has sought to correct the clearly unreasonable results of the operation of the fuel adjustment clause by a *prospective* amortization or reduction in rates to adjust for *past* unreasonable inflation of fuel expense. This Court has told the Commission specifically in the *City of Los Angeles* cases that *prospective* adjustments to correct for the *past* inflated effects of tax expense related charges are within the authority of this Commission. The Commission has not exceeded that authority here in correcting a situation entirely unintended when the fuel clause adjustment procedure was adopted.

III.

CONCLUSION

It is important to remember that the fuel clause adjustment procedure was proposed by Edison in 1972. At that time Edison represented to the Commission that the clause was a special procedure whereby Edison would be reimbursed for rapidly escalating fossil fuel costs on a dollar-

for-dollar matching of expenses and revenues. Edison specifically represented that the clause was to have no impact on its rate of return. The Commission adopted the clause on this basis recognizing the necessity for some expeditious procedure to preserve the financial integrity of Edison (and other California utilities) then faced with the rapidly rising fuel costs that were a large percentage of the utility's entire costs. Because of the cost estimating procedure adopted, substantial collection of revenues in excess of actual costs resutled. In theory, overcollections resulting from weather cycles should have been offset *in time* by undercollections caused by reversals and leveling out of these cycles. The accelerating overcollections, however, necessitated a revision of the fuel cost estimating procedure prior to any reversal of cycles. Upon completing such a revision, the Commission was faced with disposition of the unintended and purely fortuitous overcollections. The other major California electric utilities agreed to a prospective amortization of these windfalls. Edison determined to include them as part of its profit, a result never intended or proposed by Edison when it first offered the fuel clause for the Commission's consideration.

The decision of the Commission in effect balances out the matching of costs and revenues which would have occurred if the clause where continued over a future period of weather cycles. The Commission's decision, in dealing with these overcollections resulting from a special rate procedure, is distinguishable from a general rate proceeding. There is no rollback of general rates; rather, the Commission's action, as this Court recognizes, is a prospective act to correct that windfall situation arising from a

prior excessive and unintended collection of fuel revenues over fuel costs.

The decision of this Court is just and reasonable; the petition for rehearing should be denied.

Respectfully submitted,

/s/ JANICE E. KERR

Janice E. Kerr

/s/ HECTOR ANNINOS

Hector Anninos

/s/ TIMOTHY E. TREACY

Timothy E. Treacy

5066 State Building
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Attorneys for the
Public Utilities Commission
of the State of California

April 24, 1978